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No. _____

In The

Supreme Court of the United States

THOMAS E. RALEIGH,
Chapter 7 Trustee for
Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Should tax claims in bankruptcy be given the advantage of placing the burden of proof on an objecting trustee, in contrast to the rule applicable to the claims of other creditors?

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PETITION FOR A WRIT OF CERTIORARI

Thomas E. Raleigh, Chapter 7 Trustee for the Estate of William J. Stoecker, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on June 2, 1999.

OPINIONS BELOW

The opinion of the court of appeals is reported at 179 F.3d 546 and is reproduced in Appendix A. The memorandum opinion and order of the district court is unreported and is reproduced in Appendix B. The memorandum opinion of the bankruptcy court is reported at 202 B.R. 429 and is reproduced in Appendix C. Earlier related opinions of the district court and the bankruptcy court are reported at 179 B.R. 532 and 151 B.R. 989 and are reproduced in Appendices D and E, respectively.

JURISDICTION

The judgment of the court of appeals was entered on June 2, 1999. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND RULES INVOLVED

United States Code, Title 11:

§ 501 Filing of proofs of claims or interests.

(a) A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest.

§ 502 Allowance of claims or interests.

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

Federal Rules of Bankruptcy Procedure:

Rule 3001 Proof of Claim.

(f) Evidentiary Effect. A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim.

STATEMENT OF THE CASE

Petitioner Thomas E. Raleigh is the chapter 7 trustee ("Trustee") for the bankruptcy estate of William J. Stoecker. This case involves the Trustee's objection to the allowance of a claim filed by the State of Illinois for penalties arising from the failure of a corporation of which Stoecker was an officer to pay a use tax. Jurisdiction in the district court was based on 28 U.S.C. § 1334.

Stoecker had been the president and sole director of an Illinois corporation known as Chandler Enterprises, Inc. ("Chandler"). In September, 1988, Chandler purchased a Falcon 50 airplane from an out-of-state seller. Chandler obtained a legal opinion from a member of the Chicago law firm of Lord, Bissell & Brook that Chandler's purchase of the airplane was exempt from Illinois sales and use tax.

The Illinois use tax is essentially a sales tax imposed on Illinois residents who buy personal property from out-of-state sellers. If, as is often the case, the out-of-state seller does not collect and remit the tax, the resident purchaser must file a return and pay the tax directly. Chandler filed no return, but in due course, the Illinois Department of Revenue (the "Department") made a determination that the tax was owed and issued a Notice of Tax Liability against Chandler. After Chandler failed to respond to the Notice of Tax Liability, the Department ascertained from the Illinois Secretary of State that Stoecker was an officer and director of Chandler. Based on that information, the Department issued a Notice of Penalty Liability to Stoecker informing him that he was liable for the full amount of the tax owed by Chandler, including interest and penalties. Under Illinois law, any corporate officer "who has the control, supervision or responsibility of filing returns and making payment of the amount of any [use] tax . . . who wilfully fails to file the return or make the payment . . . shall be personally liable for a penalty equal to the total amount of tax unpaid by the [corporation]. . . . " 35 ILCS 735/3-7(a). The Department's only evidence that Stoecker was a responsible officer who wilfully failed to pay the tax was the

records of the Illinois Secretary of State showing Stoecker's position as an officer and director of Chandler.

The Department filed a proof of claim in Stoecker's bankruptcy case asserting a priority claim in the amount of approximately $1,476,000, later reduced to $917,000. The basis for the Department's claim was the Notice of Penalty Liability issued to Stoecker as a "responsible officer" who "wilfully" failed to pay the use tax owed by Chandler.

Pursuant to 11 U.S.C. § 502 and Rule 3007 of the Federal Rules of Bankruptcy Procedure, the Trustee filed an objection to the Department's claim. The Trustee argued, *inter alia*, that Stoecker was not a "responsible officer" and did not wilfully fail to file a return and remit the tax within the meaning of Illinois law.

Between 1992 and 1997 there were extensive proceedings in the bankruptcy and district courts, resulting in a number of published opinions. *See* Appendices B through E. The bankruptcy court ruled that the proof of claim filed by the Department was *prima facie* evidence of the validity and amount of the claim pursuant to Federal Rule of Bankruptcy Procedure 3001(f).[1] If that *prima facie* case was rebutted by the Trustee, however, the burden of

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[1] The rule under Federal Rules of Bankruptcy Procedure 3001(f) is in accordance with prior practice under the Bankruptcy Act of 1898. *Accord, Gardner v. State of New Jersey*, 329 U.S. 565, 573 (1947) ("A proof of claim is, of course, *prima facie* evidence of its validity. . . . It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide by the consequences of that procedure.").

persuasion remained with the Department – as with any other claimant in bankruptcy – to prove its claim by a preponderance of the evidence. The bankruptcy court ultimately held, *inter alia*, that the Trustee had successfully rebutted the *prima facie* validity of the Department's claim, and that the Department had failed to prove its claim by a preponderance of the evidence. Accordingly, the bankruptcy court upheld the Trustee's objection. *In re Stoecker*, 202 B.R. 429 (Bankr. N.D. Ill. 1996).

The district court concurred with the bankruptcy court's allocation of the burden of persuasion and, because the Department had no evidence beyond the records of the Secretary of State showing Stoecker as an officer and director of Chandler, held that the bankruptcy court's decision that the Department had failed to prove its claim was not clearly erroneous and therefore affirmed.

The court of appeals reversed on the ground that the burden of proof under non-bankruptcy law controlled in claim-objection proceedings in the bankruptcy court. Disagreeing with the lower courts, the court determined that because under Illinois state tax law the burden of persuasion is on the corporate officer to disprove responsible officer liability, it was the Trustee's burden to do so in the claim-objection proceeding. Finding that the evidence offered by the Trustee, while possibly sufficient to satisfy the burden of production, was not sufficient to sustain the Trustee's burden of persuasion, the court held that the Department's claim was valid.

REASONS FOR GRANTING THE WRIT

THERE IS A CONFLICT AMONG THE CIRCUITS AND THE ISSUE IS ONE OF WIDESPREAD IMPORTANCE IN THE ADMINISTRATION OF THE BANKRUPTCY LAWS.

The courts of appeals are split on the question of whether a taxing authority bears the ultimate burden of persuasion on its claim in a bankruptcy proceeding. The Fifth, Eighth, Ninth, Tenth and Federal Circuits have held that the taxing authority bears the burden of persuasion. *Matter of Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993); *In re Brown*, 82 F.3d 801, 804-05 (8th Cir. 1996); *In re Macfarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), *cert. denied*, 520 U.S. 1115 (1997); *In re Fullmer*, 962 F.2d 1463, 1466 (10th Cir. 1992); *Bronson v. United States*, 46 F.3d 1573, 1581-82 (Fed. Cir. 1995). The Seventh Circuit has now joined the Third and Fourth Circuits in holding that the burden of persuasion is not shifted to the taxing authority by the taxpayer's filing of a bankruptcy petition. *Resyn Corp. v. United States*, 851 F.2d 660, 663 (3d Cir. 1988); *In re Landbank Equity Corp.*, 973 F.2d 265, 270-71 (4th Cir. 1992).

The frequency with which the question presented in this case arises is suggested not only by the number of cases cited and discussed in the several opinions in this case but also by the sizable number of additional cases referred to in those cases and by the continuing conflicting decisions rendered by lower courts. *Compare In re Forte*, 234 B.R. 607, 617-18 (Bankr. E.D. N.Y. 1999) *with Barrows v. I.R.S.*, 231 B.R. 446, 449-52 (D. N.H. 1998). The Seventh Circuit's decision in this case is likely to generate additional controversy and conflicts in view of the sharp clash of viewpoints and analysis reflected in the several

opinions in this case. *Cf.* Jack F. Williams, *Final Report of the Tax Advisory Committee to the National Bankruptcy Review Commission*, at Section 3, ¶211 (Aug. 1997).[2] Moreover, none of the lengthy bankruptcy-related bills currently pending in Congress addresses the allocation of the burden of proof in tax claim objection proceedings. *See* Bankruptcy Reform Act of 1999, H.R. 833, 106th Cong., 1st Sess. (1999); Bankruptcy Reform Act of 1999, S. 625, 106th Cong., 1st Sess. (1999); Consumer Bankruptcy Reform Act of 1999, S. 945, 106th Cong., 1st Sess. (1999).

The question presented in this case arises in every case in which a debtor, a trustee, a creditor's committee or an individual creditor files an objection to a governmental tax claim. The overwhelming majority of the million plus bankruptcy cases filed each year involve claims for state, local or federal taxes. Thus, resolution of the question presented in this case is important to the administration of bankruptcy cases throughout the country.

As a general rule, the ultimate burden of proof on a claim against a debtor's estate rests with the claimant. *Matter of Carlson*, 126 F.3d 915, 921 (7th Cir. 1997). Accordingly, a number of courts have held that, regardless of the

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[2] The Tax Advisory Committee considered three proposals concerning allocation of the burden of proof: first, to impose the burden of proof existing under non-bankruptcy law; second, to subject taxing authorities to the same burdens of proof imposed on other creditors under the Bankruptcy Code and Rules; and third, to allow the bankruptcy court to place the burden of proof where appropriate when the objector is not the debtor, *e.g.*, the trustee or another creditor. By divided votes, the Advisory Committee endorsed the first and third proposals and rejected the second.

allocation of the burden of proof in tax litigation outside bankruptcy, a taxing authority, like any other creditor, bears the ultimate burden of proving its claim in a bankruptcy proceeding. *E.g., In re Macfarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), *cert. denied*, 520 U.S. 1115 (1997); *In re Brown*, 82 F.3d 801, 805 (8th Cir. 1996); *Matter of Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993); *In re Fullmer*, 962 F.2d 1463, 1466 (10th Cir. 1992). Other courts, including the Seventh Circuit in this case, have held that the burden of proof under non-bankruptcy law applies.

Courts embracing the latter view ignore or minimize the federal interests supporting a uniform allocation of the burden of proof in bankruptcy cases. Outside bankruptcy, the dispute is entirely between the taxpayer and the taxing authority. Thus, the rationale for placing the burden of proof on the taxpayer – that the taxpayer has greater knowledge of its financial affairs and access to its own records – is controlling. Once the taxpayer becomes a bankrupt debtor, however, the dispute is not between the taxing authority and the debtor, but between the taxing authority and the debtor's other creditors who compete for the assets in the debtor's estate. The debtor's creditors or creditors' committee or trustee have no greater access to the debtor's records than does the taxing authority, nor did they have any ability to influence the integrity or accuracy of the debtor's pre-petition record keeping. Moreover, because many tax claims are entitled to priority treatment under 11 U.S.C. §§ 507 and 726 and may be exempt from discharge under 11 U.S.C. § 523 (without the filing of a proof of claim), taxing authorities are already placed at a decided advantage over other

unsecured creditors. Thus, as other courts have recognized, the policy considerations underlying the general rule that a taxpayer bears the burden of persuasion no longer control when the taxpayer becomes a bankrupt debtor:

> The rule regarding the placing of the burden of proof on the taxpayer in tax cases generally presumably arises from the superior access which a taxpayer has to its own records and knowledge of its own affairs, relative to that of the IRS. . . . This policy evaporates if someone other than the taxpayer, *e.g.*, a trustee or another creditor, is pressing the objection. Also driving the allocation of the burden is the assumption that the taxpayer wishes to avoid paying taxes to serve its own economic self-interest. While the Debtor-taxpayer is the party challenging the instant assessment, it is doing so in its role as a debtor-in-possession, in which it is placed in the role of a fiduciary for all of the Debtor's creditors. Therefore, self-interest, while present, is muted somewhat from that of the ordinary taxpayer and involves the interests of third parties who are not parties to the immediate dispute.

In re Compass Marine Corp., 146 B.R. 138, 146 (Bankr. E.D. Pa. 1992). *See In re Arndt*, 201 B.R. 853, 858 (M.D. Fla. 1996) ("Granting a taxing authority . . . a presumption of correctness to their claim ignores the differences between a typical district court or tax court proceeding, where only one claim is at issue, and a bankruptcy proceeding, where many claims are subject to the court's determination."); *In re Brady*, 110 B.R. 16, 18 (Bankr. D. Nev. 1990) ("the estate is a party in interest and not just the taxpayer").

The Seventh Circuit, rejecting the argument for equal treatment of creditors, noted that the Bankruptcy Code reflects a conscious Congressional decision to give more favorable treatment to tax creditors in many instances. While taxing authorities are given favorable treatment under various sections of the Bankruptcy Code, they are not the only creditors so favored, yet they are the only creditors to benefit from not having the burden of persuasion on their underlying claims if the Seventh Circuit's view prevails. Among the priority claims identified in 11 U.S.C. § 507, seven classes of claimants enjoy higher priority than taxing authorities, but all these other priority claimants bear the ultimate burden of proof on their claims. Moreover, a taxing authority, like any other claimant seeking to exempt its claim from discharge under 11 U.S.C. § 523 (except a non-debtor former spouse seeking nondischargeability under § 523(a)(15)), bears the burden of proof as to all elements of nondischargeability. *Grogan v. Garner*, 498 U.S. 279, 287 (1991); *Matter of Crosswhite*, 148 F.3d 879, 884-86 (7th Cir. 1998); *In re Gamble*, 143 F.3d 223, 226 (5th Cir. 1998).

Nothing in the Bankruptcy Code evidences any Congressional intent to favor tax creditors with respect to the burden of proof in a claim objection proceeding. Because the Code does not make an exception for tax creditors to the burden applicable to all claimants in a claim objection proceeding, the bankruptcy and district courts correctly held in this case that the burden of persuasion lay with the Illinois Department of Revenue.

CONCLUSION

For the reasons stated, a writ of certiorari should issue to review the judgment of the Seventh Circuit.

Respectfully submitted,

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APPENDIX A

In the

United States Court of Appeals

for the Seventh Circuit

No. 98-3590

IN RE: WILLIAM STOECKER,

Debtor,

APPEAL OF: STATE OF ILLINOIS, Department of Revenue

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 97 C 414 – Wayne R. Andersen, *Judge.*

ARGUED APRIL 16, 1999 – DECIDED JUNE 2, 1999

Before POSNER, *Chief Judge,* and BAUER and ROVNER, *Circuit Judges.*

POSNER, *Chief Judge.* This bankruptcy appeal has a complicated procedural history that we shall ignore; the curious are referred to 151 B.R. 989 (Bankr. N.D. Ill. 1992); 179 B.R. 532 (N.D. Ill. 1994), and 202 B.R. 429 (Bankr. N.D. Ill. 1996). All that matters is that the bankruptcy court eventually disallowed Illinois's claim against the debtor's estate for some $900,000 in unpaid Illinois use tax (including interest), Ill. Rev. Stat. ch. 120, ¶ 439.12 (1989), which was owed on the purchase of a corporate aircraft. (The current statute, 35 ILCS 105/12, has a narrower

scope, but we shall cite to it because the provisions that we discuss are materially the same.) The district court affirmed the disallowance, precipitating this appeal by the state against the trustee in bankruptcy.

The plane had been bought by Chandler Enterprises, Inc., an Illinois company (now defunct) of which Stoecker was president. The state claims that Stoecker is liable for the tax as a "responsible officer" of Chandler. 35 ILCS 735/3-7. If this is right, the liability is a debt of the estate in bankruptcy.

Chandler had asked Jack Prewitt & Associates (JPA), an established buyer and seller of corporate jets, to find one for it. JPA located a suitable jet that was for sale by Bezwada Investments and agreed with Chandler to broker the purchase. But Chandler did not have the cash to pay the plane's full purchase price, which was in excess of $12 million, right away; so JPA turned to an affiliate, Prewitt Leasing, Inc. (PLI), which does airplane leasing and financing, for help with the sale. JPA bought the plane from Bezwada and transferred the title from itself to PLI. PLI then entered into an "Aircraft/Lease Purchase Agreement" with Chandler under which Chandler agreed to pay PLI $2.4 million immediately to be "applied to the final purchase price of the aircraft" and $10 million more (plus interest denominated "lease payments" on the $10 million) in 90 days if it decided to buy. Until the purchase option was exercised, title would remain in PLI. But during the 90-day option period, Chandler would have the full use of the plane and indeed could modify it as it saw fit. In June 1998, Chandler took delivery of the plane and transported it to Illinois and in September it exercised the option and PLI transferred

title to it. Thus the transaction was Bezwada-JPA-PLI-Chandler.

The Illinois use tax is a sales-tax substitute imposed on Illinois residents (which Chandler is conceded to be, or rather to have been, since it is now defunct) who buy from out-of-state sellers. If the seller doesn't pay the tax, the buyer must file a return and pay the tax and in the case of aircraft the return must be filed and the tax paid within 30 days after the aircraft enters the state. 35 ILCS 105/10. When no return is filed – and Chandler filed no return – the Illinois Department of Revenue determines the amount of tax due and issues a Notice of Tax Liability to the taxpayer. 35 ILCS 105/12, 120/4. Unless the taxpayer protests the notice within the time provided, it become [sic] a final assessment although it is still subject to judicial review in the Illinois circuit court. 35 ILCS 120/4, 12.

The taxpayer may not be the only one liable for a tax. Under Illinois law, any corporate officer "who has the control, supervision or responsibility of filing returns and making payment of the amount of any . . . tax . . . who willfully fails to file the return or make the payment . . . shall be personally liable for a penalty equal to the total amount of tax unpaid by the [corporation]." 35 ILCS 735/3-7. The Department determines the penalty, and its determination is "prima facie evidence of a penalty due." *Id.* It embodies this determination in a Notice of Penalty Liability which is sent to the officer. The procedures for challenging a Notice of Penalty Liability are similar to those for challenging a Notice of Tax Liability.

Chandler not only failed to file a use-tax return; it failed to register the plane with the Illinois Department of Aviation, as it was required to do. As a result, it took the Department of Revenue years to discover that Chandler owed use tax and by that time the company was defunct and Stoecker, its president, was in bankruptcy. The Department issued both a Notice of Tax Liability, futilely, against Chandler and a Notice of Penalty Liability against Stoecker.

There are two principal issues. The first, which the district court resolved in favor of the state, is whether Chandler owed use tax on the purchase of the plane. The second, which the court resolved in favor of the trustee, is whether, if Chandler did owe use tax, Stoecker is liable for that tax as a responsible officer. Since Chandler, now a ghost, cannot pay the tax, the court's second ruling spelled defeat for the state. The trustee defends the second ruling but attacks the first, arguing that no use tax was owed, in which event Stoecker had no responsible-officer liability regardless.

The district court thought itself and the bankruptcy court barred by the Tax Injunction Act, 28 U.S.C. § 1341, from reexamining Chandler's liability for use tax. The Act forbids federal courts to enjoin the assessment or collection of state taxes unless the taxpayer has no adequate remedy in the state courts. But Illinois is not trying to extract taxes from Chandler. It is trying to get a penalty in lieu of taxes from Stoecker's estate in bankruptcy. Its right to do so depends on whether Chandler owed use tax, and the district judge thought that a federal court cannot decide an issue of state tax law. That is incorrect. The Bankruptcy Code expressly authorizes bankruptcy

courts to decide tax issues, 11 U.S.C. § 505(a)(1), and although *state* taxes are not specified, the courts have interpreted the statute to cover them. *Adams v. Indiana*, 795 F.2d 27, 29 (7th Cir. 1986); *City Vending of Muskogee, Inc. v. Oklahoma Tax Comm'n*, 898 F.2d 122, 123-24 (10th Cir. 1990) (per curiam). The Act is anyway addressed only to injunctive remedies (or a declaratory judgment viewed as a preliminary to an injunction, *National Private Truck Council, Inc. v. Oklahoma Tax Comm'n*, 515 U.S. 582, 586 (1995)), and no one is seeking an injunction against the state's going after Chandler for the taxes that the state believes Chandler owes it. If federal courts could not determine the debtor's liability for state taxes – if they had to abstain pending a determination of that liability in state court – bankruptcy proceedings would be even more protracted than they are.

So we can consider the trustee's argument against that liability, and it is that PLI's sale of the aircraft to Chandler was an "isolated or occasional sale of tangible personal property at retail by a person who does not hold himself out as being engaged (or who does not habitually engage) in selling such tangible personal property at retail." 35 ILCS 105/2. An example would be a good bought at a garage sale; no use tax would be due. See 86 Ill. Admin. Code § 130.110(b) (1991); cf. *Knowledge Data Systems v. Utah State Tax Comm'n*, 865 P.2d 1387 (Utah App. 1993); *Nevada Tax Comm'n v. Bernhard*, 683 P.2d 21 (Nev. 1984) (per curiam).

PLI, unlike its affiliate JPA, was not engaged in the regular sale of aircraft at retail (or at wholesale, for that matter). In fact the sale to Chandler was apparently the first sale of an aircraft that PLI had made. The trustee

thus wants us to confine our attention to the transfer of title from PLI to Chandler. But that would be myopic. PLI is the financing arm of JPA, which is a retailer of aircraft. JPA found the plane for Chandler, took title to it from its previous owner, Bezwada, and brought PLI in to finance Chandler's purchase of it. Bezwada was (so far as we can tell) not a retailer. But JPA was and it acted as the intermediary in the sale to Chandler, at one point actually holding title, as in the ordinary retail sale where the retailer buys from a supplier and resells to a consumer. The fact that title passed from the retailer to its affiliate before coming to rest with Chandler did not make PLI the real seller. Otherwise transactions would be easily structured to avoid use tax by having an out-of-state retailer transfer title to its nonretailer affiliate for retransfer to the in-state purchaser. The "substance over form" doctrine of tax law, on which see *Gregory v. Helvering*, 293 U.S. 465 (1935); *Segal v. Commissioner*, 41 F.3d 1144, 1148 (7th Cir. 1994); *Yosha v. Commissioner*, 861 F.2d 494 (7th Cir. 1988); *ACM Partnership v. Commissioner*, 157 F.3d 231, 246-47 (3d Cir. 1998), would presumably allow the state to defeat the bankruptcy trustee's attempt to invoke the "isolated or occasional sale" exemption by recharacterizing the transaction as a sale by JPA to Chandler. Cf. *Continental Illinois Leasing Corp. v. Department of Revenue*, 439 N.E.2d 118 (Ill. App. 1982).

But this analysis is incomplete, because there is another and equally good way of playing "substance over form" in this case, and that is to treat the "real" sale as Bezwada to Chandler, with JPA and PLI holding title merely as security for financing the sale. See UCC §§ 1-201(37), 9-102, 810 ILCS 5/1-201(37), 5/9-102; *Orix*

Credit Alliance, Inc. v. Pappas, 946 F.2d 1258 (7th Cir. 1991); *Tilghman Hardware, Inc. v. Larrimore*, 628 A.2d 215 (Md. 1993). This particular application of the "substance over form" doctrine, however, is nixed by Illinois law, which expressly treats a transfer of title to a retailer as a sale even if the purpose is merely to grant a security interest. 86 Ill. Admin. Code § 130.1060(a); Illinois Dept. of Revenue Private Letter No. 92-0113, 1992 WL 154376 (Feb. 27, 1992). JPA took title; JPA is a retailer; therefore use tax was due on the subsequent transfer of title by JPA to Chandler.

So Chandler was liable for the tax and the next question is whether Mr. Stoecker was liable too under the "responsible officer" rule. The record contains no evidence about the structure, scale, or operations of Chandler – even about what business it was engaged in – except that we do know that it had an officer named Pluhar who acted as the company's financial officer. There is no evidence concerning Stoecker's role in the filing of Chandler's tax returns or the payment of any taxes due, and so no proof either that he was responsible for these corporate functions or that he willfully evaded the payment of the use tax. But just as under the corresponding federal law of responsible-officer liability for unpaid taxes, 26 U.S.C. § 6672; *United States v. Running*, 7 F.3d 1293, 1297 (7th Cir. 1993); *United States v. McCombs*, 30 F.3d 310, 318 (2d Cir. 1994), Illinois shifts the burden of proof – both production and persuasion – to the officer once a Notice of Penalty Liability is issued, *Branson v. Department of Revenue*, 659 N.E.2d 961, 968 (Ill. 1995); and the trustee has not carried it. He may have satisfied his burden of production by identifying Pluhar as Chandler's

corporate financial officer, but he has not satisfied the burden of persuasion. Stoecker was the president and as far as we know he and Pluhar were the only officers and both deeply involved in the tax affairs of their corporation.

It is true that, just as under the corresponding federal law, *Wright v. United States*, 809 F.2d 425, 427 (7th Cir. 1987), the failure to pay must be willful, implying at least gross negligence. *Branson v. Department of Revenue, supra*, 659 F.2d [sic: N.E.2d] at 965. Chandler had an opinion letter from a reputable lawyer that no tax was due because JPA really had just a security interest; and reliance on a reputable lawyer's opinion letter can negate willfulness, *Marrin v. Commissioner*, 147 F.3d 147, 152 (2d Cir. 1998); cf. *Hall v. Aqua Queen Mfg., Inc.*, 93 F.3d 1548, 1555 (Fed. Cir. 1996); *Westvaco Corp. v. International Paper Co.*, 991 F.2d 735, 743-44 (Fed. Cir. 1993), though it's not an automatic safe harbor. *Marrin v. Commissioner, supra*, 147 F.3d at 152-53; *O'Connor v. United States*, 956 F.2d 48, 52 n. * (4th Cir. 1992); *Smith v. United States*, 894 F.2d 1549, 1554 (11th Cir. 1990). But no evidence was presented that Stoecker ever saw the letter, let alone that he relied on it. There is no other evidence bearing on the issue of willfulness.

So the burden of proof is critical, and the trustee argues that whatever the rule under state law, the burden is on the state when the issue of responsible-officer liability is adjudicated in a bankruptcy proceeding. This shift is necessary, he contends, to promote "equality" among creditors in bankruptcy. Bankruptcy is an equitable procedure, and "equality is equity" (and vice versa),

Cunningham v. Brown, 265 U.S. 1, 13 (1924); *Scott v. Armstrong*, 146 U.S. 499, 511 (1892); *United States v. Real Property*, 89 F.3d 551, 554 (9th Cir. 1996); *Downriver Community Federal Credit Union v. Penn Square Bank*, 879 F.2d 754, 761 (10th Cir. 1989); *White v. Carolina Paperboard Corp.*, 564 F.2d 1073, 1087 (4th Cir. 1977), as numerous bankruptcy cases intone. E.g., *In re Elcona Homes Corp.*, 863 F.2d 483, 484 (7th Cir. 1988); *In re Joliet-Will County Community Action Agency*, 847 F.2d 430, 434 (7th Cir. 1988). These truisms have a particular appeal for those bankruptcy judges who would like to administer the bankruptcy laws in accordance with their personal notions of fairness. But it is now well settled that although the origins, procedures, and many of the remedies of bankruptcy are indeed equitable, a bankruptcy judge has no authority to cut down the entitlements that creditors seek to enforce in bankruptcy, except (see, e.g., *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983)) as provided by the Bankruptcy Code itself. *United States v. Noland*, 517 U.S. 535, 543 (1996); *Butner v. United States*, 440 U.S. 48, 55-56 (1979); *In re Carlson*, 126 F.3d 915, 920 (7th Cir. 1997); *In re FBN Food Services, Inc.*, 82 F.3d 1387, 1396 (7th Cir. 1996); *In re Lapiana*, 909 F.2d 221, 223 (7th Cir. 1990); *In re Landbank Equity Corp.*, 973 F.2d 265, 271 (4th Cir. 1992).

Bankruptcy is not a "free-for-all equity balancing act." *In re Lapiana, supra*, 909 F.2d at 224. It is a forum in which creditors prove the entitlements that state or federal law confers on them, and these entitlements are then enforced consistently with the provisions of the Code governing preferences, priority, and other issues that arise in the marshaling and collection of debts from a bankrupt debtor, none of which affects a state's tax claim.

An equity free-for-all would engender confusion and uncertainty and increase the strategic incentives to petition for bankruptcy either of debtors, if the bankruptcy court curtailed entitlements, or of creditors, if it expanded them. The closest to the power here asserted of a free-wheeling equitable discretion to cut down entitlements when they are sought to be enforced in a bankruptcy proceeding is the power of equitable subordination. 11 U.S.C. § 510. But it must be exercised case by case and not over a whole class of claims. *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213, 228-29 (1996); *United States v. Noland, supra*, 517 U.S. at 543; cf. *In re Envirodyne Industries, Inc.*, 79 F.3d 579, 581 (7th Cir. 1996).

Burden of proof is rightly classified as a part of the creditor's entitlement, implying that it is not shifted in bankruptcy. *In re Landbank Equity Corp., supra*, 973 F.2d at 270, so holds, though *In re Macfarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), is to the contrary. We acknowledged the division of authority in *In re Carlson, supra*, 126 F.3d at 921, without having to choose. Today we choose, and we choose *Landbank*. It is supported by the general pattern of American tax law, in which "payment precedes defense, and the burden of proof, normally on the claimant, is shifted to the taxpayer," *Bull v. United States*, 295 U.S. 247, 260 (1935), and by the countless cases which hold that burden of proof is "substantive" for purposes of the Erie doctrine, e.g., *Director v. Greenwich Collieries*, 512 U.S. 267, 271 (1994); *American Dredging Co. v. Miller*, 510 U.S. 443, 454 (1994); *Dick v. New York Life Ins. Co.*, 359 U.S. 437, 446 (1959); *Koppers Co. v. Aetna Casualty & Surety Co.*, 98 F.3d 1440, 1446 (3d Cir. 1996), in recognition of the critical

importance of burden of proof to a person's rights. Illinois has given its taxing authorities an entitlement to collect a penalty tax pursuant to a Notice of Penalty Liability that is defeasible only if the taxpayer can persuade the adjudicator that the tax is not due. That is different from an entitlement to collect the taxes listed in the notice upon proof by the state that the tax is due. On the latter view, the Notice of Penalty Liability really is just a notice, conferring no rights, adding nothing to the Notice of Tax Liability; on the former view, which seems to us the sound view, the Notice of Penalty Liability creates a defeasible right.

Congress can alter entitlements in bankruptcy, and sometimes does so, but there is no indication that it meant to shift the burden of proof from taxpayer to tax collector. Rather the contrary. The Code itself grants a favored position to claims of unpaid taxes, 11 U.S.C. §§ 507(a)(8), 523(a)(1) (we're about to see another example); and the close attention that the drafters of the Code paid to issues of burden of proof, e.g., 11 U.S.C. §§ 362(g), 363(o), 364(d)(2), 547(g), 1129(d), makes their silence on the burden of proof in tax cases eloquent. The position for which the trustee contends has no more basis in the Code than in the law of Illinois, and it would create a new incentive to declare bankruptcy. We have enough bankruptcies.

The last string to the trustee's bow is the argument that the state's tax claim was untimely. Bankruptcy Rule 3002(c) requires, with immaterial exceptions, that a proof of claim be filed with the bankruptcy court within 90 days after the first date set for the meeting of creditors, which in this case would have been by June 26, 1990. See

also Bankr. R. 9006(b)(3). The state's claim was not filed until 18 months later and it was therefore untimely. But in a conflict between the Code and the rules, the Code controls, 28 U.S.C. § 2075; *In re Pacific Atlantic Trading Co.*, 33 F.3d 1064, 1066 (9th Cir. 1994), and it permits – without even a loss of priority – the filing of certain untimely claims (other than by the debtor, *In re Danielson*, 981 F.2d 296 (7th Cir. 1992)), including the state's tax claims in this case. See 11 U.S.C. §§ 507(a)(8)(E), 726(a)(1). This is crystal clear under the current version of section 726(a)(1), but was clear enough under the old version, e.g., *Cooper v. Internal Revenue*, 167 F.3d 857 (4th Cir. 1999), the one applicable to this suit, though some courts disagreed. See cases cited in *id.* at 859.

The exception for instances of inexcusable delay, in which the tardy claim may be equitably subordinated to timely claims, 11 U.S.C. § 726(a) (incorporating § 510), is not available to Stoecker. Chandler's failure to register the aircraft or file a tax return prevented the state from discovering Stoecker's liability until long after the bankruptcy proceeding was commenced, an express purpose of the requirement of registration being to make sure that "all applicable fees and taxes shall be paid." 620 ILCS 5/42.

We conclude that the state has a valid claim against Stoecker's estate and that the decision of the district court must therefore be reversed.

We wish in closing to commend counsel for both parties (Benjamin Goldgar for the state and Robert

Radasevich for the trustee) for their excellent briefs and argument.

REVERSED AND REMANDED.

A true Copy:

Teste:

/s/ _____
Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re WILLIAM J. STOECKER, Debtor	)	No. 97 C 414
STATE OF ILLINOIS, DEPARTMENT OF REVENUE, Appellant, v.	)	Judge Wayne R. Andersen
THOMAS E. RALEIGH as Trustee of the Estate of William J. Stoecker, Appellee.	)	

MEMORANDUM OPINION AND ORDER

This matter is before the Court on the appeal of the State of Illinois Department of Revenue (the "Department") from the United States Bankruptcy Court for the Northern District of Illinois. *In re Stoecker*, 202 B.R. 429 (Bankr. N.D. Ill. 1996) (Squires, Bank. J.). The Bankruptcy Court granted in part and denied in part the motion for summary judgment of Thomas E. Raleigh. Raleigh is the Chapter 7 trustee (the "Trustee") of the estate of William J. Stoecker (the "Debtor"). The Trustee's objection to the Department's proof-of-claim in the Debtor's estate was sustained in part by the Bankruptcy Court and the Department's claim was disallowed. For the following

reasons, we affirm the decision of the Bankruptcy Court granting in part the Trustee's motion for summary judgment. We disagree with the Bankruptcy Court's holding that Chandler Enterprises, Inc. ("Chandler"), a third party non-debtor, did not owe the assessed use tax in the first instance.

I. BACKGROUND

For a more complete rendition of the facts of this case, see *In re Stoecker*, 202 B.R. 429. The Debtor was the president and sole director of Chandler. Chandler's financial officer was Lawrence Pluhar ("Pluhar"). In 1988, Chandler purchased an aircraft from Prewitt Leasing, Inc. ("Prewitt Leasing"). Neither Chandler nor Prewitt Leasing paid any Illinois use tax on Chandler's purchase of the aircraft. The Debtor asserts that his attorney advised him that no use tax was assessable or payable as a result of the purchase. Chandler was involuntarily dissolved by the Illinois Secretary of State on June 1, 1990.

The instant lawsuit began as an involuntary Chapter 11 bankruptcy petition against the Debtor. The petition was converted to a Chapter 7 bankruptcy petition on February 26, 1990. Pursuant to 11 U.S.C. § 341(a), the creditors held a meeting on March 28, 1990. Pursuant to Fed. R. Bankr. P. 3002(c), all proofs of creditor claims had to be filed on or before June 26, 1990, ninety days after the meeting, or the claims would be barred.

On September 7, 1990, the Department issued a Notice of Tax Liability against Chandler for the unpaid tax on the aircraft pursuant to 35 ILCS 105/12. After

Chandler failed to pay the assessed use tax, the Department issued a Notice of Penalty Liability against the Debtor pursuant to the Illinois Retailer's Occupation Tax Act, 35 ILCS 120/13.5. This statute provides that a "responsible officer" of a corporation may be held liable if the corporate taxpayer fails to pay taxes to the Department. The Debtor never paid the assessed use tax.

On January 21, 1992, approximately 18 months after the June 26, 1990 bar date, the Department filed a proof of claim against the Debtor's estate in the amount of $1,476,196.86 for the use tax allegedly owed by the Debtor because he was a responsible officer of Chandler. When the Trustee objected to the Department's late-filed proof of claim, the Bankruptcy Court sustained the objection and did not allow the Department's claim. The Department appealed the Bankruptcy Court's ruling.

In August 1994, this Court reversed the Bankruptcy Court's ruling and remanded the matter based on our finding that Fed. R. Bankr. P. 3002(c) does not act as an absolute bar date for creditor claims. *In re Stoecker*, 179 B.R. 532, 534 (N.D. Ill. 1994). We also directed the Bankruptcy Court to determine whether the Department's late-filed claim should be subordinated under the principles of equitable subordination. In a supplemental order, we reversed the Bankruptcy Court's decision to disallow the claim and remanded the matter to determine whether the Debtor is liable for the use tax as a responsible officer of Chandler. *Id.*

At the status hearing following the remand order, the trustee moved for summary judgment after the contested claim was set for trial. On April 29, 1996, the Bankruptcy

Court held a hearing pursuant to this Court's remand order. At that hearing, the parties submitted testimony and exhibits from the 1992 hearings, designated deposition transcripts and exhibits, and offered additional exhibits, but no witnesses testified.

On October 17, 1996, the Bankruptcy Court granted in part and denied in part the Trustee's motion. The Bankruptcy Court held that Chandler did not owe the use tax. The Bankruptcy Court also found that the Department failed to prove that the Debtor was a responsible officer of Chandler and that the Debtor had willfully failed to pay the alleged use tax. Finally, the Bankruptcy Court ruled that if the Department's claim had been allowed, the claim would not have been equitably subordinated under 11 U.S.C. § 510(c).

The Department filed the instant appeal on five grounds: (1) the Bankruptcy Court erroneously allocated the burden of proof; (2) the Bankruptcy Court had no jurisdiction to redetermine Chandler's tax liability; (3) the Bankruptcy Court erroneously found that Chandler was not liable for the tax; (4) the Bankruptcy Court erroneously held that the Debtor was not a "responsible officer" of Chandler; and (5) the Bankruptcy Court erroneously found that the Debtor's failure to pay the tax was not "willful."

The proof-of-claim action was a core proceeding before the Bankruptcy Court under 28 U.S.C. § 157(b)(2)(B). This Court has appellate jurisdiction pursuant to 28 U.S.C. § 158(a).

II. DISCUSSION

A. Standard Of Review

As a conclusion of law, a grant of summary judgment is reviewed de novo. The district court will affirm summary judgment "if there is no genuine issue as to any material fact and if the moving party is entitled to judgment as a matter of law." *McGinn v. Burlington N. R.R. Co.*, 102 F.3d 295, 298 (7th Cir. 1996). Summary judgment may be affirmed on any ground supported in the record, even if it was not relied upon by the court below. *Johnson v. Gudmundsson*, 35 F.3d 1104, 1115 (7th Cir. 1994).

The non-movant must set forth specific facts showing that there is a genuine issue as to any material fact. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986). The non-movant may not merely rest upon allegations in the pleadings or affidavits; rather he must go beyond the pleadings and support any contentions with proper documentary evidence. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986). The language of Fed. R. Civ. P. 56(c) mandates the entry of summary judgment against a non-movant who fails to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. *Id.* at 322. Fed. R. Bankr. P. 7056 makes Fed. R. Civ. P. 56 applicable to adversary proceedings in bankruptcy.

The Bankruptcy Court made findings of fact and conclusions of law in accordance with Fed. R. Bankr. P. 7052 which incorporates Fed. R. Civ. P. 52. The district court must accept a Bankruptcy Court's findings of fact unless clearly erroneous. Fed. R. Bankr. P. 8013; *In re Merchants Grain, Inc.*, 93 F.3d 1347, 1351 (7th Cir. 1996),

cert. denied, 117 S. Ct. 948 (1997); *In re Tolona Pizza Prod. Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993). The Bankruptcy Court's conclusions of law must be examined *de novo*. *In re Merchants Grain, Inc.*, 93 F.3d at 1351; *In re Yonikus*, 996 F.2d 866, 868 (7th Cir. 1993).

B. Responsible Officer Liability

We must first rule on the Debtor's liability for Chandler's assessed Illinois use tax. The Debtor can be held liable for the unpaid taxes of a corporate taxpayer if he meets a two-prong test. First, he must be a "responsible officer" of the delinquent corporation. Second, his failure to pay the tax must have been "willful." 35 ILCS 120/13.5.

In our remand order, we directed the Bankruptcy Court to consider the Department's Notice of Penalty Liability against the Debtor as *prima facie* evidence that the Debtor was a responsible officer who willfully failed to pay the use tax assessed against Chandler. *In re Stoecker*, 179 B.R. at 544. Because most of the issues in responsible officer liability involve issues of fact, our review is conducted under a clearly erroneous standard. Fed. R. Bankr. P. 8013; *In re Merchants Grain, Inc.*, 93 F.3d at 1351.

1. Allocation of burden of proof and persuasion for a contested claim

The parties dispute which party has the ultimate burden of proof for a contested proof of creditor claim.

This question is an issue of law and is, thus, subject to *de novo* review. *Celotex*, 477 U.S. at 322.

The Department argues that, under Illinois law, the Trustee must disprove the elements of "responsible officer" liability. The Trustee contends that under both federal and Illinois law the ultimate burden of proof rests with the Department. The Bankruptcy Court held that the ultimate burden of proof rests with the Department. We agree with the Bankruptcy Court.

A creditor's proof of claim in a bankruptcy proceeding constitutes "*prima facie* evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f). If the Trustee overcomes the *prima facie* proof of claim, "the burden is again on the creditor to produce a preponderance of evidence establishing the validity of the claim." *Bank of Bellwood v. Stoecker (In re Stoecker)*, 143 B.R. 879, 883 (N.D. Ill. 1992), *aff'd in part, vacated in part on other grounds*, 5 F.3d 1022 (7th Cir. 1993). It is well established that, outside of the bankruptcy forum, the taxpayer bears the ultimate burden of proof for a contested claim. *United States v. General Dynamics Corp.*, 481 U.S. 239, 245 (1987); *In re MacFarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), *cert. denied sub. nom, California Franchise Tax Bd. v. MacFarlane*, 117 S. Ct. 1243 (1997). In bankruptcy proceedings, however, after a debtor has rebutted the *prima facie* validity of a claim, the ultimate burden rests with the creditor to prove the validity of the claim. *Bank of Bellwood*, 143 B.R. at 883; *In re Holm*, 931 F.2d 620, 623 (9th Cir. 1991). Thus, there is some tension when a taxing authority – itself not accustomed to bearing the burden of proof – is required to bear this burden in a bankruptcy proceeding.

Although this issue has not yet reached the Seventh Circuit, a majority of circuits reaching the issue have decided that once a Trustee has presented evidence to rebut the *prima facie* valid claim of a taxing authority, the taxing authority bears the ultimate burden of proving its claim. *See, e.g., In re Brown*, 82 F.3d 801, 804-805 (8th Cir. 1996); *In re MacFarlane*, 83 F.3d at 1045; *In re Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993); *In re Fullmer*, 962 F.2d 1463, 1466 (10th Cir. 1992). The Third and Fourth Circuits, however, have reached an opposite conclusion. *See, e.g., In re Landbank Equity Corp.*, 973 F.2d 265, 268-272 (4th Cir. 1992); *Resyn Corp. v. United States*, 851 F.2d 660, 663 (3rd Cir. 1988).

We agree with the Fifth, Eighth, Ninth, and Tenth Circuits. Indeed, we find the Ninth Circuit's reasoning in *In re MacFarlane* to be particularly persuasive since the claims of taxing authorities are already given priority over some other claimants under 11 U.S.C. § 507(a). The Ninth Circuit held that removing the burden of proof would grant the taxing authority a double benefit not authorized by statute. *In re MacFarlane*, 83 F.3d at 1045. In addition, "the policy goals of the bankruptcy system are put at risk when one class of creditors is given the benefit of a favorable presumption which has its origins outside of bankruptcy law." *In re Wilhelm*, 173 B.R. 398, 402 (Bankr. E.D. Wis. 1994) (deciding that the Internal Revenue Service bears the ultimate burden of proof in a bankruptcy proceeding).

Accordingly, in light of the specific order of claim priorities already listed in 11 U.S.C. § 507(a), we find that creditors should be treated equally with respect to the required burden of proof. The Department should not

gain a favorable presumption regarding the burden of proof, particularly when that presumption arises outside of bankruptcy law. *Accord In re MacFarlane*, 83 F.3d at 1045; *Wilhelm*, 173 B.R. at 402. The decision of the Bankruptcy Court, placing the ultimate burden of proof on the Department, is, therefore, affirmed.

2. The debtor was not a "responsible officer" of Chandler

In order to establish that the Debtor was a "responsible officer" under the Illinois Retailer's Occupation Tax Act, the Department must prove that the Debtor had "control, supervision, or responsibility for filing returns and making payment of the amount of tax herein imposed. . . . " 35 ILCS 120/13.5. In *United States Internal Revenue Serv. v. Charlton*, 2 F.3d 237, 240 (7th Cir. 1993), the Seventh Circuit addressed "responsible person" liability within the meaning of 26 U.S.C. § 6672 of the Internal Revenue Code, a provision somewhat analogous to § 13.5 of the Illinois Retailers Occupation Tax Act. There, the court found that several factors are relevant to the determination of whether a person is a responsible officer within the meaning of § 6672. *Id.* These factors include whether the person holds corporate office, has the authority to disburse funds on behalf of the company, and has the ability to hire and fire employees. *Id.* But, "[t]he true objective of this inquiry, and the sine qua non of liability under § 6672, is a determination that the taxpayer had the authority to allocate funds to pay the company's other debts in preference to its debt to the IRS." *Id.*

The Bankruptcy Court found that the Department "failed to introduce sufficient evidence to adequately prove that the Debtor had actual control, supervision, or responsibility for making payment of the tax allegedly owed by Chandler." *In re Stoecker*, 202 B.R. at 455. Furthermore, the Bankruptcy Court held that "there is no direct evidence . . . linking the Debtor to Chandler's day to day operations and the payment of its bills and taxes in the course of its business." *Id.* at 454. Finally, the Bankruptcy Court stated that "the limited evidence adduced showed that Pluhar, [Chandler's financial officer,] not the Debtor, was responsible for and in control of Chandler's finances." *Id.* at 455.

The Department contends that the delegation of disbursal responsibilities to Pluhar is insufficient, by itself, to relieve the Debtor of liability. Due to the lack of other evidence implicating the Debtor as a responsible officer, this argument is insufficient to hold that the Bankruptcy Court's finding is clearly erroneous. Indeed, we find the reasoning of the Bankruptcy Court to be persuasive and well supported by the evidence. Accordingly, we affirm the Bankruptcy Court's finding that the Debtor was not a "responsible officer" within the meaning of the Illinois Retailer's Occupation Tax Act.

3. The debtor's failure to pay the tax was not willful

Next, we examine the second prong of responsible officer liability, the requirement of "willfulness." 35 ILCS 120/13.5. The Illinois Supreme Court defined "willful failure to pay taxes" for the purpose of § 13.5 of the

Illinois Retailer's Occupation Tax Act as "intentional, knowing, and voluntary acts" or, alternatively, "[the] reckless disregard for obvious or known risks." *Branson v. Department of Revenue*, 168 Ill.2d 247, 255 (1995).

Chandler's outside counsel advised Chandler that the purchase of the aircraft did not create a use tax liability. The Bankruptcy Court found that Pluhar, as the officer responsible for Chandler's finances, reasonably relied on outside counsel's advice. Accordingly, the Bankruptcy Court found that the Debtor, through his agent Pluhar, relied on the opinion letter in deciding not to pay the tax. The Bankruptcy Court stated, " . . . the [D]ebtor's reliance on this opinion letter negates a finding that he acted consciously, voluntarily, intentionally, knowingly, or recklessly in his failure to pay the assessed tax." *In re Stoecker*, 202 B.R. at 457. Finally, the Bankruptcy Court held that "the totality of the evidence does not demonstrate that the Debtor's failure to pay the tax showed a 'gross negligence involving a known risk of violation' and was therefore willful." *Id.*

The Department maintains that the Bankruptcy Court's reasoning is flawed. Chandler's legal counsel issued the opinion letter on September 30, 1988. But, according to the Department, the sale of the aircraft took place on June 7, 1988. Thus, the Department argues that Chandler could not have relied on the opinion letter because the letter was not even issued until after the use tax was incurred and became payable. We disagree.

The date of sale for the aircraft is a factual finding to be reviewed by this Court under the clearly erroneous standard. *In re Merchant's Grain*, 93 F.3d at 1351. The

Bankruptcy Court held that the sale occurred on September 30, 1988, not on June 7, 1988 as the Department contends. The Bankruptcy Court found that "the Aircraft Purchase Agreement between Prewitt Leasing and Chandler is dated September 30, 1988." *In re Stoecker*, 202 B.R. at 460. Also, the Notice of Penalty Liability issued by the Department against Chandler asserts that the aircraft was purchased in September 1988. *Id.* Finally, "[the Department's] proof of claim [against the Debtor's estate] indicates a sale date of September 30, 1988." *Id.* In light of this evidence, we hold that the Bankruptcy Court's findings of fact regarding the date of sale are not clearly erroneous.

Based on its findings, the Bankruptcy Court also found that the Trustee successfully rebutted the presumption of willfulness that attached to the Notice of Penalty Liability. *In re Stoecker*, 202 B.R. at 463. The burden then shifted to the Department to prove the Debtor's willful failure to pay by a preponderance of the evidence. The Bankruptcy Court found that the Department did not met [sic] the burden of proof, and, therefore, that the Debtor did not willfully fail to pay the use tax. *Id.* at 462. For the same reasons given by the Bankruptcy Court, we affirm this finding as not in clear error.

Thus, we affirm the Bankruptcy Court's ruling that the Debtor was not a "responsible officer" who "willfully" failed to pay the tax assessed against Chandler. Accordingly, the Debtor is not liable for Chandler's outstanding use tax.

C. The Bankruptcy Court Cannot Redetermine The Tax Liability Of Chandler

We instructed the Bankruptcy Court to decide whether Chandler owed the assessed tax if it found that the Debtor was a responsible officer who willfully failed to pay the use tax assessed against Chandler. *In re Stoecker*, 179 B.R. at 541. In essence, we affirmed the Bankruptcy Court's jurisdiction to redetermine Chandler's tax liability based on the plain language of 11 U.S.C. § 505(a)(1), which states that the court is authorized to "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." *Id.* (*citing In re Stoecker*, 151 B.R. 989, 990-999 (Bankr. N.D. Ill. 1992)). The Bankruptcy Court held that Chandler did not owe the use tax, and, because the Debtor's liability was contingent upon Chandler's liability, the Debtor did not owe the tax. *In re Stoecker*, 202 B.R. at 451. Despite our holding that the Debtor was not a responsible officer of Chandler, see *supra* § II.B, the resolution of the Bankruptcy Court's jurisdiction to redetermine Chandler's liability is important because it affects Chandler's ultimate liability for the use tax. We now hold that the Bankruptcy Court did not have jurisdiction to redetermine Chandler's tax liability.

The Department contends that the Tax Injunction Act, 28 U.S.C. § 1341, creates a jurisdictional bar preventing the Bankruptcy Court from redetermining the tax liability of Chandler, a third party non-debtor. The Bankruptcy

Court did not address this argument in its opinion and the Department now raises it for the first time in this appeal. The subject matter jurisdiction of the court may be challenged by a party or raised sua sponte by the court at any time during the proceedings. *Jackson v. Consolidated Rail Corp.*, 717 F.2d 1045, 1054 (7th Cir. 1983), *cert denied*, 465 U.S. 1007 (1984); Fed. R. Civ. P. 12(h)(3). Accordingly, we will now consider whether the Bankruptcy Court could properly redetermine the use tax assessed against Chandler.

The Tax Injunction Act provides that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy, and efficient remedy may be had in the courts of such state." 28 U.S.C. § 1341. The principal purpose of § 1341 was "to limit drastically federal court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 522 (1981). Indeed, Congress intended to divest "the federal courts of jurisdiction to interfere with state tax administration." *California v. Grace Brethren Church*, 457 U.S. 393, 410 (1982). Yet, these rulings seem in apparent conflict with 28 U.S.C. § 1334(b), which grants the district court jurisdiction over "all civil proceedings arising under Title 11, or arising in or *related to* cases under Title 11." 28 U.S.C. § 1334(b) (emphasis added). *See also* 28 U.S.C. § 157(a) (stating that "[e]ach district court may provide that any or all cases under Title 11 . . . or arising in or related to a case under Title 11 shall be referred to the bankruptcy judges for the district").

One recent court held that the Tax Injunction Act § 1341 does apply if a bankruptcy court is asked to enjoin

tax collection efforts against a third party. *McCrory Corp. v. State of Ohio*, 212 B.R. 229, 231 (S.D.N.Y. 1997). Moreover, with § 1334's "plain, speedy, and efficient" language, "[t]he obvious intention of Congress was to leave the door open for an injunction against local tax assessments if the assessed party did not have a reasonable opportunity to challenge the assessment in court." *Id.* at 232-233.

Though *McCrory Corp.* is not precedential authority, its reasoning is persuasive. Pursuant to the plain meaning of § 1341, the district court may not decide state tax issues if a plain, speedy, and efficient remedy is available in the state court. Accordingly, the dispositive jurisdictional issue is whether the Illinois use tax assessed against Chandler and, subsequently, the Debtor, could have been resolved in a plain, speedy, and efficient manner in the Illinois state court system.

The Department assessed a use tax against Chandler and sent two letters demanding payment on March 7, 1990 and June 7, 1990, respectively. Chandler did not respond to either letter. *In re Stoecker*, 202 B.R. at 442. On September 7, 1990, the Department issued a Notice of Tax Liability against Chandler for the use tax plus penalties and interest. Chandler had twenty days to protest the Notice of Tax Liability, but it did not respond. *Id.* With no timely protest filed, pursuant to Illinois law, the Notice of Tax Liability became a final tax assessment. On June 15, 1991, the Department issued a Notice of Penalty Liability against the Debtor as a purported "responsible officer" of Chandler.

At many stages prior to the final assessment, Chandler had reasonable opportunity to protest the use tax. We find that such remedy is precisely the "plain, speedy, and efficient" remedy contemplated by § 1341. Thus, while it is true that Chandler is not the debtor in bankruptcy, the assessed use tax is ultimately assessed against Chandler. The Debtor's derivative liability for this tax is contingent upon Chandler's liability. Therefore, it does not matter if the Debtor himself protested the use tax assessment because Chandler itself had an adequate opportunity to protest. The Debtor has been afforded the opportunity to protest the "responsible officer" determination, not Chandler's tax. *See supra*, § II.B.

Because the Department properly assessed the use tax against Chandler and afforded it the opportunity to protest the assessment, the Bankruptcy Court cannot redetermine the assessment under § 1341. Nonetheless, this rule may be relaxed if circumstances are so exceptional that enforcement of the assessed tax liability against an alleged "responsible officer" creates an inequitable situation for that individual. For example, if a corporation becomes insolvent or is dissolved and fails [sic] protest the assessment of a tax, a court could not normally redetermine the tax. If, however, the Department seeks to impose derivative-liability for the assessed tax on an officer of that corporation, before that officer can be liable as a "responsible officer," he must be afforded the opportunity [sic] protest the assessment. Accordingly, we reverse the Bankruptcy Court's holding that Chandler did not owe the assessed use tax.

D. The Bankruptcy Court Should Not Equitably Subordinate The Department's Proof Of Claim

The Department asserts that the issue of equitable subordination was not properly before the Bankruptcy Court because the Trustee never filed an adversary proceeding as required by Fed. R. Bankr. P. 7001(8). We disagree.

A party may waive its right to object to another party's failure to file an adversary proceeding. *See In re Pence*, 905 F.2d 1107, 1109 (7th Cir. 1990). The Bankruptcy Court noted the Department's argument but found that it had agreed to waive the formal requirement for an adversary proceeding. *In re Stoecker*, 202 B.R. at 463. For the same reasons given by the Bankruptcy Court, we do not find this procedural ruling to be in clear error. The Department has waived its right to object and, therefore, the issue of equitable subordination is properly before the Court.

The doctrine of equitable subordination is codified at 11 U.S.C. §510(c), which provides in relevant part:

> (c) Notwithstanding subsections (a) and (b) of this section, after notice and hearing, the court may –
>
> > (1) under principles of equitable subordination, subordinate for the purpose of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest. . . .

This statute recognizes the Bankruptcy Court's role as a court of equity and permits the court to disallow or

subordinate some claims in favor of other claims in order to produce just results. *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1248 (7th Cir. 1990).

A court must consider three elements in deciding whether to subordinate a claim: (1) whether the creditor engaged in misconduct; (2) whether that misconduct resulted in injury to the other creditors or an unfair advantage to the creditor engaged in misconduct; and (3) whether subordination of the debt would be inconsistent with other provisions of the Bankruptcy Code. *In re Vitreous Steel Prods. Co.*, 911 F.2d 1223, 1237 (7th Cir. 1990). While misconduct is not necessarily required to subordinate a claim, the inquiry must focus on the fairness to all creditors involved. *See Id.; In re McDonald Creek Dev. Co.*, No. 95 C 4988, 1996 WL 139396,*1 (N.D. Ill. March 20, 1996) (*citing In re Virtual Network*, 902 F.2d at 1246).

The Bankruptcy Court ruled that the Department's claim should not be equitably subordinated. *In re Stoecker*, 202 B.R. at 465. The decision of the Bankruptcy Court concerning equitable subordination is reviewed on the basis of clear error. *In re Osborne*, 42 B.R. 988, 992 (W.D. Wis. 1984). The Bankruptcy Court found that "[t]he evidence supports a finding that [the Department's] failure to timely file the instant claim by the bar date was not intentional or deliberate." *Stoecker*, 202 B.R. at 465. The Trustee's request for equitable subordination was therefore denied. Accordingly, we find that the Bankruptcy Court's ruling is not clearly erroneous and affirm.

E. The Department Did Not Issue The Notice Of Penalty Liability In Violation Of The Automatic Stay

Prior to the Department issuing a Notice of Penalty Liability on June 15, 1991, an automatic stay provided by 11 U.S.C. § 362(a) was in effect over the Debtor's estate. The automatic stay preserves the status quo as of the date of the bankruptcy filing. *See In re Carlson*, 189 B.R. 454, 458 (Bankr. N.D. Ill. 1995), *aff'd*, 198 B.R. 949 (N.D. Ill. 1996), *aff'd*, 126 F.3d 915 (7th Cir. 1997), *cert. denied*, 118 S. Ct. 1388 (1998). The Trustee contends that the Department violated this stay by filing its Notice of Penalty Liability and thus, the Notice is void.

Pursuant to 11 U.S.C. § 362(c), an automatic stay is no longer in effect under the following circumstances:

> (1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and
>
> (2) the stay of any other act under subsection (a) of this section continues until the earliest of –
>
> (A) the time the case is closed;
>
> (B) the time the case is dismissed; or
>
> (C) if the case is a case under chapter 7 of this title concerning an individual . . . , *the time a discharge is granted or denied.*

(emphasis added).

The Department asserts that, when it made its claims against the Debtor, it did so against the Debtor and not

against the Debtor's estate. Furthermore, as the Bankruptcy Court noted, the Debtor consented to a denial of his discharge on November 28, 1990. *In re Stoecker*, 202 B.R. at 445. Thus, pursuant to the plain language of § 362(c)(2)(C), the automatic stay was not in effect as to the Debtor when the Department's actions were taken. The Bankruptcy Court ruled that "the [Notice of Penalty Liability] is not void because the automatic stay as to the Debtor and his property was no longer in effect as of November 28, 1990. Hence, the Court finds [the Department's] actions were not in violation of the automatic stay." *In re Stoecker*, 202 B.R. at 445. Additionally, the Bankruptcy Court rejected the Trustee's contention that the Department's actions were against the Debtor's estate and thus violative of the stay provided in § 362(c)(1). *Id.* We affirm the Bankruptcy Court's reasoning on this issue and find that it is not clearly erroneous.

III. CONCLUSION

For the foregoing reasons, we affirm the decision of the Bankruptcy Court granting in part the Trustee's motion for summary judgment. We affirm the Bankruptcy Court's finding that the Debtor was not a responsible officer who willfully failed to pay the use tax assessed against Chandler. The Trustee's objection to the Department's proof of claim is sustained and the claim is, therefore, disallowed.

In addition, pursuant to the Tax Injunction Act, we find that under the circumstances of the instant matter, the Bankruptcy Court does not have jurisdiction to redetermine the tax liability of Chandler, a third party

non-debtor. Accordingly, we reverse the Bankruptcy Court's finding that Chandler did not owe the assessed use tax. Had it become necessary to reach the issue of equitable subordination, we would affirm the Bankruptcy Court's decision not to equitably subordinate the Department's claim. Finally, we affirm the Bankruptcy Court's finding that the Department's Notice of Penalty Liability was not issued in violation of the automatic stay.

It is so ordered.

/s/ Wayne R. Andersen
Wayne R. Andersen
United States District Judge

Dated: September 10, 1998

APPENDIX C

In re William J. STOECKER, Debtor.

Bankruptcy No. 89 B 02873.

United States Bankruptcy Court,
N.D. Illinois,
Eastern Division.

Oct. 17, 1996.

Robert Radasevich, George M. Hoffman, David A. Eide, Neal Gerber & Eisenberg, Chicago, IL, for Thomas E. Raleigh, Chapter 7 Trustee.

James W. Newbold, Assistant Attorney General, Office of the Attorney General, Chicago, IL, for Illinois Department of Revenue.

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MEMORANDUM OPINION

JOHN H. SQUIRES, Bankruptcy Judge.

This matter comes before the Court on a remand order from the United States District Court for the Northern District of Illinois to determine whether William J.

Stoecker (the "Debtor"), as a responsible officer of a non-debtor corporation, Chandler Enterprises, Inc. ("Chandler"), willfully failed to pay a use tax assessed against Chandler. A motion for summary judgment on this and related issues was filed by Thomas E. Raleigh, the Chapter 7 trustee (the "Trustee") for the Debtor's estate, which is opposed by the responding creditor claimant, the Illinois Department of Revenue ("IDOR"). For the reasons set forth herein, the Court hereby partially grants the motion for summary judgment. The Trustee's objection to IDOR's claim is sustained in part and the claim is disallowed. The Court holds that Chandler did not owe the assessed use tax in the first instance. Moreover, the Court holds that IDOR has failed to prove that the Debtor willfully failed to pay the use tax. Finally, the Court will not equitably subordinate IDOR's claim under 11 U.S.C. § 510(c).

I. *JURISDICTION AND PROCEDURE*

The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334(b) and General Rule 2.33(A) of the United States District Court for the Northern District of Illinois. This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(B).[1] *See In re Stoecker*, 151 B.R.

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[1] IDOR does not dispute the Court's jurisdiction to hear an objection to its claim against the Debtor. IDOR contends that the Court lacks jurisdiction to determine the tax liability of a non-debtor corporation such as Chandler. The District Court, in reversing and remanding the matter, held that this Court had the jurisdiction to decide Chandler's liability for the assessed use tax. *See In re Stoecker*, 179 B.R. 532, 541 (N.D.Ill.1994). IDOR has raised the issue at this stage to preserve same for possible appeal. A more detailed address of this argument can be found herein. *See* pp. 445-52 *infra*.

989, 991 (Bankr.N.D.Ill.1992), *rev'd and remanded*, 179 B.R. 532 (N.D.Ill.1994).

II. *APPLICABLE STANDARDS*

A. *Burden of Proof for a Contested Proof of Claim*

Pursuant to Federal Rule of Bankruptcy Procedure 3001(f), "[a] proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Fed.R.Bankr.P. 3001(f); *see also* 11 U.S.C. §§ 501 and 502(a). Claim objectors carry the initial burden to produce some evidence to overcome this rebuttable presumption. *Bank of Bellwood v. Stoecker (In re Stoecker)*, 143 B.R. 879, 883 (N.D.Ill.1992), *aff'd in part vacated in part*, 5 F.3d 1022 (7th Cir.1993). However, the ultimate burden of persuasion always remains with the claimant to prove entitlement to the claim. *Franchise Tax Board of the State of California v. MacFarlane*, 83 F.3d 1041, 1045 (9th Cir.1996); *Brown v. Internal Revenue Service (In re Brown)*, 82 F.3d 801, 804-05 (8th Cir.1996); *In re Octagon Roofing*, 156 B.R. 214, 218 (Bankr.N.D.Ill.1993). IDOR's properly filed claim constitutes prima facie evidence of the validity and amount of the claim. The Trustee has the burden of presenting evidence to rebut the prima facie validity. If that burden is satisfied, IDOR then bears the ultimate burden of proving its claim. *See MacFarlane*, 83 F.3d at 1045.

B. *Summary Judgment Under Federal Rule of Civil Procedure 56 and Federal Rule of Bankruptcy Procedure 7056*

In order to prevail on a motion for summary judgment, the movant must meet the statutory criteria set forth in Rule 56 of the Federal Rules of Civil Procedure, made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056. Rule 56(c) reads in part:

> [T]he judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed.R.Civ.P. 56(c). The primary purpose for granting a summary judgment motion is to avoid unnecessary trials when there is no genuine issue of material fact in dispute. *Trautvetter v. Quick*, 916 F.2d 1140, 1147 (7th Cir.1990); *Farries v. Stanadyne/Chicago Div.*, 832 F.2d 374, 378 (7th Cir.1987) (quoting *Wainwright Bank & Trust Co. v. Railroadmen's Federal Sav. & Loan Ass'n of Indianapolis*, 806 F.2d 146, 149 (7th Cir.1986)).

In 1986, the United States Supreme Court decided a trilogy of cases which encourage the use of summary judgment as a means to dispose of factually unsupported claims. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986); *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The burden is on the

Yachts, 29 F.3d 1153, 1156 (7th Cir.1994). "Summary judgment is not an appropriate occasion for weighing the evidence; rather the inquiry is limited to determining if there is a genuine issue for trial." *Lohorn v. Michal*, 913 F.2d 327, 331 (7th Cir.1990). However, "[i]f evidence opposing summary judgment is merely colorable or is not significantly probative, summary judgment may be granted." *Anderson*, 477 U.S. at 249-50, 106 S.Ct. at 2511 (citations omitted); *see also Griffin v. Air Line Pilots Ass'n. Int'l.*, 32 F.3d 1079, 1084 (7th Cir.1994). When the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial and summary judgment must be granted. *Matsushita*, 475 U.S. at 587, 106 S.Ct. at 1356.

C. *Summary Judgment Implemented by Local Bankruptcy Rule 402*

Local Rule 402.M of the Bankruptcy Rules adopted for the Northern District of Illinois requires the party moving for summary judgment to file, among other things, a detailed statement ("402.M statement") of material facts that the movant believes are uncontested. Local Bankr.R. 402.M.[2] The 402.M statement "shall consist of

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[2] M. Motions for Summary Judgment; Moving Party.

With each motion for summary judgment filed pursuant to Fed.R.Civ.P. 56 (Fed.R.Bankr.P. 7056), the moving party shall serve and file –

(1) any affidavits and other materials referred to in Fed.R.Civ.P. 56(e);

(2) a supporting memorandum of law; and

The party opposing a summary judgment motion is required by Local Rule 402.N to respond ("402.N statement") to the movant's 402.M statement, paragraph by paragraph, and to set forth any material facts that would require denial of summary judgment, specifically referring to the record for support of each denial of fact. Local Bankr.R. 402.N.[3] The 402.N statement filed by IDOR complies with Rule 402.N. In the filing, IDOR responds "to each numbered paragraph in the moving party's statement" and makes "specific references to the affidavits,

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[3] N. Motions for Summary Judgment; Opposing Party.

Each party opposing a motion under Fed.R.Civ.P. 56 (Fed.R.Bankr.P. 7056) shall serve and file the following:

(1) any opposing affidavits and other materials referred to in Fed.R.Civ.P. 56(e);

(2) a supporting memorandum of law; and

(3) a concise response to the movant's statement of facts that shall contain:

(a) a response to each numbered paragraph in the moving party's statement, including, in the case of any disagreement, specific references to the affidavits, parts of the record, and other supporting materials relied upon; and

(b) a statement, consisting of short numbered paragraphs, of any additional facts that require the denial of summary judgment, including references to the affidavits, parts of the record, and other supporting materials relied upon. All material facts set forth in the statement required of the moving party will be deemed to be admitted unless controverted by the statement of the opposing party.

Local Bankr.R. 402.N.

Trustee's reply to IDOR's 402.N statement, and from the entire record before the Court are as follows:

On February 21, 1989, an involuntary proceeding under Chapter 11 of the Bankruptcy Code was initiated against the Debtor. On March 20, 1989, Thomas E. Raleigh was appointed Chapter 11 Trustee of the Debtor's estate. Thereafter, on February 26, 1990, this case was converted to a Chapter 7, and Raleigh was reappointed as the Chapter 7 Trustee. By order dated March 5, 1990, the Court set the 11 U.S.C. § 341 meeting of creditors for March 28, 1990. That order provided that all proofs of claim were to be filed within 90 days after the § 341 meeting, on or before June 26, 1990. On November 28, 1990, pursuant to an agreed order, the Debtor consented to the denial of his discharge.

A. *IDOR's Procedures re Bankruptcy Cases of Taxpayer Debtors*

It is the practice of IDOR's bankruptcy unit, upon receiving notice that an individual has filed, voluntarily or involuntarily, for bankruptcy relief, to research all potential liability that person may have to IDOR by running a computer search using the debtor's social security number. (Tr. (MacDonald) 103).[4] Such a search reveals the names and Illinois business tax numbers of all corporations of which a debtor is an officer, provided that the corporation is registered with IDOR. *Id.* Once the computer search reveals that a debtor in bankruptcy is an

[4] Transcript references are to the testimony received during the 1992 evidentiary hearings.

officer of a corporation registered in Illinois, two things happen. First, a search is made to see if the corporation has outstanding taxes due IDOR. (Tr. (MacDonald) 103-04). If it is determined that there are outstanding corporate taxes and the debtor may be held personally liable for the corporate taxes as a responsible officer, the bankruptcy unit files a claim in the bankruptcy case. *Id.* Second, the bankruptcy unit encodes IDOR's computer system with information indicating that an officer of a corporation is in bankruptcy so that any employee of IDOR who checks the information concerning the corporation will know immediately that the officer is in bankruptcy. (Tr. (Petersen) 111).

The actions set forth above are performed for a number of reasons including the purpose of informing IDOR's auditors of the pendency of any bankruptcy case involving an officer of any corporation against which they may conduct an audit. *Id.* If an auditor finds that an officer of a corporation that he is auditing is in bankruptcy, it is IDOR's procedure to require the auditor to immediately advise the bankruptcy unit of any audit so that a claim can be promptly filed. (Tr. (Russell) 43).

B. *IDOR's Procedures Applied in the Debtor's Case*

IDOR's bankruptcy unit in Chicago received notice of the Debtor's bankruptcy filing sometime shortly after the filing of the involuntary petition. Upon receipt of the notice of the Debtor's bankruptcy filing, Lawrence MacDonald ("MacDonald") of IDOR's bankruptcy unit, was assigned the task of researching the Debtor's liability to IDOR and filing the appropriate claims. (Tr. (MacDonald)

102-03). As part of MacDonald's research, he ran the Debtor's social security number through IDOR's computer system and determined that there were a number of corporations of which the Debtor was an officer. (Tr. (MacDonald) 103). The corporations associated with the Debtor included The Cook's Cupboard, Inc., Eagle Line, Inc., and a number of other corporations. (Tr. (MacDonald) 103-04). MacDonald's search of IDOR's then extant database revealed no outstanding tax liability owed by corporations other than The Cook's Cupboard, Inc. and Eagle Line, Inc. (Tr. (MacDonald) 104). IDOR's computer records containing the registration information concerning these other corporations were encoded to show that the Debtor, as an officer, was in bankruptcy. (Tr. (Petersen) 115-16). At the time this was done in 1989, IDOR had no registration for Chandler that could be encoded to show that the Debtor, as an officer of Chandler, was in bankruptcy. *Id.* Apparently, Chandler was not registered with IDOR when the search was performed. *Id.*

C. *IDOR's Other Timely Filed Claims Not in Dispute Here*

On July 25, 1989, prior to conversion of the case to a Chapter 7, IDOR filed three proofs of claim in the amounts of $12,667.00, $1,330.21, and $222.03. These proofs of claim were for taxes owed by the Debtor as the responsible officer of The Cooks' Cupboard, Inc.[5] and

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[5] On November 17, 1989, IDOR filed an amended proof of claim asserting additional taxes owed by the Debtor as responsible officer of The Cook's Cupboard, Inc.

Prewitt & Associates") transferred title to Prewitt Leasing.[9] (IDOR's Exhibit No. 6). Title was previously transferred to Jack Prewitt & Associates by Opex Aviation, Inc. on June 1, 1988. (IDOR's Exhibit No. 5). Opex Aviation, Inc. had obtained title to the Aircraft from Bezwada Investments, Inc., an Australian company ("Bezwada"), on May 30, 1988. (Trustee's Exhibit No. 8). Due to a mistake on the part of Raymond Prewitt or William White, a now deceased employee of Jack Prewitt & Associates, title to the Aircraft was incorrectly transferred from Opex Aviation, Inc. to Jack Prewitt & Associates. (Jack Prewitt Dep. 41-44). Instead, on June 1, 1988, title should have been transferred from Opex Aviation, Inc. to Prewitt Leasing. *Id.*

Neither Chandler nor Prewitt Leasing paid any sales or use tax in connection with Chandler's purchase of the Aircraft. The purchase of the Aircraft was financed by NEMLC Leasing Corporation ("NEMLC") of Boston, Massachusetts. At NEMLC's request, John Anderson ("Anderson"), an attorney with the law firm of Lord, Bissell & Brook, who acted as counsel for Chandler and Grabill Corporation, a company that leased the Aircraft from Chandler, issued an opinion letter on September 30,

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[9] IDOR fails to deny or admit this statement in its 402.N statement. The failure to properly or adequately controvert proper assertions in the 402.M statement of facts results in the assertions being deemed admitted. *South Cent. Bank & Trust Co. v. Citicorp Credit Servs., Inc.*, 863 F.Supp. 635, 643 n. 10 (N.D.Ill.1994). *Accord Davis v. Frapolly*, 756 F.Supp. 1065, 1069 n. 4 (N.D.Ill.1991). Consequently, pursuant to Local Bankr.R. 402.N(3)(b), this material fact set forth by the Trustee is deemed to be admitted because same has not been controverted.

was an officer and director of Chandler. (IDOR's Exhibit Nos. 19 and 20). As a part of his assignment, Russell obtained a report of various aircraft purchased by Illinois residents from a company named Aerofax. (Tr. (Russell) 16). Aerofax is a company that obtains reports from the Federal Aviation Administration in Oklahoma City of all sales of aircraft in the United States and disseminates these reports to all parties subscribing to its reporting service. *Id.* The Aerofax report showed a transaction in which title was transferred to Jack Prewitt & Associates, out of Bedford, Texas, to Chandler in Oak Forest, Illinois. (Tr. (Russell) 17).

Chandler never registered with IDOR nor did it file any tax returns with IDOR, including any tax returns with respect to its purchase of the Aircraft. (Tr. (Russell) 41-42). After Chandler acquired the Aircraft, it did not register the Aircraft with the Illinois Department of Transportation's Division of Aeronautics. (IDOR's Exhibit No. 21). Furthermore, it is undisputed that Chandler never sought from IDOR a determination that the purchase of the Aircraft was exempt from tax.

IDOR determined that Chandler owed an unpaid use tax, and therefore assessed a use tax totaling $836,500 (plus interest and penalties) against Chandler for the purchase of the Aircraft. (IDOR's Exhibit No. 4). On March 7, 1990, and June 7, 1990, IDOR sent Chandler two letters demanding payment of the use tax. (IDOR's Exhibit Nos. 3 and 4). IDOR did not receive a response to either letter. (Tr. (Russell) 22). In June 1990, Russell learned that the Debtor was an officer of Chandler and, at

15, 1991, IDOR issued a Notice of Lien to the Debtor. (Trustee's Exhibit No. 5). On September 25, 1991, IDOR issued a demand to the Debtor for full and immediate payment of the use tax liability claimed. (IDOR's Exhibit No. 13). On October 3, 1991, IDOR recorded with the Cook County Recorder of Deeds a lien in the amount of $1,476,196.86, representing the assessed use tax, penalties, and interest. (Trustee's Exhibit No. 6).

E. *The Instant Claim Objection and Proceedings Prior to the Remand Order and Subsequent Thereto*

In January 1992, Brenda Towers, supervisor of the notice of penalty liability section of IDOR, was advised that the Debtor had filed bankruptcy (Tr. (Towers) 98). On January 21, 1992, nearly two years after IDOR began its investigation and more than one and one-half years after the claims bar date, and approximately one and one-half years after Russell discovered that the Debtor was an officer of Chandler, and almost three years after IDOR first received notice that the Debtor was in bankruptcy, IDOR filed the proof of claim that is the subject of this claim objection. (IDOR's Exhibit No. 17).[12] The basis for

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[12] The amount claimed by IDOR pursuant to its amended claim is as follows: a 11 U.S.C. § 507(a)(7) priority claim of $911,769 consisting of $868,351 in use tax and $43,418 in pre-petition interest. IDOR concedes that the penalty portion of its claim, namely, $260,505 is not entitled to priority, and in fact, is subordinated to claims of general unsecured creditors pursuant to 11 U.S.C. § 726(a)(4).

The total amount in the original claim was $1,476,197. (IDOR's Exhibit No. 17). The difference in the amounts set forth

the Aircraft without paying retailers' occupation tax/use tax (Ill.Rev.Stat., ch. 120, ¶ 440 *et seq.* and ¶ 439.1 *et seq.* (1991)). The Trustee objected to IDOR's claim, and on July 30, and August 27, 1992, the Court held evidentiary hearings.

On November 25, 1992, the Court entered a Memorandum Opinion and Order finding that IDOR had failed to establish that the Debtor willfully failed to pay or owed the responsible officer penalty resulting from Chandler's failure to pay the claimed use tax. *See Stoecker*, 151 B.R. at 1000-01. Further, the Court found that IDOR's claim was untimely and would not be allowed. *Id.* at 996-98.

The Court's decision was appealed to the United States District Court for the Northern District of Illinois. On August 31, 1994, Judge Andersen reversed the Court's finding that the bar date for filing claims in the Debtor's Chapter 7 case applied to IDOR's priority tax claim under 11 U.S.C. § 507(a)(7),[13] and reversed the Court's decision to disallow the claim on the merits. *See Stoecker*, 179 B.R. at 533-39. Further, the District Court remanded this matter to determine whether the Debtor was a responsible officer who willfully failed to pay an assessed tax against

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computation of the unpaid use tax claimed by IDOR to be owed, but unpaid, by Chandler.

[13] The Bankruptcy Code has been amended since this case was filed in 1989, and has changed the designations of certain sections and subsections at issue in this contested proceeding. Section 507(a)(7) was recodified as § 507(a)(8). References to sections and subsections of the Bankruptcy Code in this Opinion, however, are to the text of the Code in effect when the case was filed in 1989.

who willfully failed to pay the use tax allegedly owed; and (4) IDOR's claim is untimely. Additionally, the Trustee argues that if the Court finds IDOR's claim proper, it should be equitably subordinated pursuant to 11 U.S.C. § 510(c). The Court will address the bases for the Trustee's objection to IDOR's claim in turn.[14]

IV. *DISCUSSION*

A. *Did IDOR Issue the NPL in Violation of the Automatic Stay, Thus Rendering It Void?*

The Trustee contends that IDOR violated the automatic stay in the following post-petition instances: (1) when it issued the NPL against the Debtor on June 15, 1991; (2) when it made the demand for full payment of the NPL from the Debtor on September 25, 1991; and (3) when it recorded the lien against the Debtor on October 3, 1991.[15] IDOR does not dispute that it took such actions.

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[14] The Court previously sustained the Trustee's objection that IDOR's claim is untimely. *See Stoecker*, 151 B.R. at 996-98. However, the District Court reversed this Court's decision on this issue. 179 B.R. at 539. Accordingly, the Court is bound to follow that ruling as law of the case. *See Cole Energy Dev. Co. v. Ingersoll-Rand Co.*, 8 F.3d 607, 609 (7th Cir.1993) (law of the case doctrine requires lower court judge to comply with rulings made by higher court in the same case). The Trustee has reasserted this ground at this stage solely to preserve the issue in the event of future appeals. This Court will not further address this issue.

[15] At the time IDOR took the actions in question, there was in effect the automatic stay provided in Section 362(a) of the Bankruptcy Code, 11 U.S.C. § 362(a). Section 362(a) provides in relevant part, as follows:

The Trustee argues that § 362(c)(2)(C) does not apply to the matter at bar because IDOR seeks to employ the NPL to obtain property of the bankruptcy estate, not merely to proceed against the Debtor and his post-petition property. The Trustee contends that because IDOR is now seeking to obtain satisfaction of its claim from property of the estate, relying on the prima facie validity that attached to the NPL, that the post-petition NPL issued to the Debtor violates the automatic stay. The Trustee states that it is undisputed that the assets from which IDOR seeks recovery on its claim are funds in the Trustee's possession realized from the liquidation of the Debtor's prepetition property, and constitute property of the estate. According to the Trustee then, the denial of the Debtor's discharge is irrelevant to IDOR's claim against the estate because § 362(c)(1) and not § 363(c)(2)(C) applies in this case. As such, the Trustee argues the automatic stay, which prevents actions taken against property of the estate, was still in effect when the NPL was issued, currently remains in effect, the actions taken violated the stay, and the NPL is void.

IDOR claims that when it issued the NPL to the Debtor, made demand upon him, and recorded the lien, it did so against the Debtor and not against the estate. Thus, IDOR concludes that § 363(c)(2)(C) applies and the automatic stay was not in effect when it took these three actions against the Debtor. IDOR maintains that it never asserted that this lien was against the Trustee or property of the estate, and thus, there was no violation of the stay.

The Court agrees with IDOR's position because it was not until January 21, 1992, that IDOR sought to recover its claim from property of the bankruptcy estate

sovereign immunity since the District Court's decision, in which the District Court held that this Court properly found that it had jurisdiction under 11 U.S.C. § 505(a) to determine the tax liability of a non-debtor, third party such as Chandler.[16] Accordingly, IDOR maintains that the Court should reconsider that earlier decision based upon these Supreme Court cases.

1. *Sovereign Immunity Does Not Prevent the Court From Redetermining Chandler's Liability For the Use Tax*

Initially, the Court must address IDOR's argument that the Court is precluded under the principle of sovereign immunity from redetermining Chandler's liability for the use tax. This argument was previously raised and rejected by both this Court and the District Court. *See Stoecker,* 151 B.R. at 998-99; *Stoecker,* 179 B.R. at 541. Section 106 of the Bankruptcy Code was amended by the Bankruptcy Reform Act of 1994.[17] *See* Bankruptcy Reform

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[16] *Stoecker,* 179 B.R. at 541; *see also Stoecker,* 151 B.R. at 998-99. The Court stands by its reasoning contained therein, and will not repeat its analysis and discussion.

[17] Section 113 of the Bankruptcy Reform Act provides in relevant part:

> Section 106 of title 11, United States Code, is amended to read as follows:
>
> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following
>
> (1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525,

Act of 1994, Pub.L. No. 103-394, § 113, 108 Stat. 4106 (1994). Most significantly, the amendment to § 106 applies

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> 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.
>
> (2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.
>
> (3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(2)(A) of title 28.
>
> (4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States.
>
> (5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.
>
> (b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property

retroactively. *Id.* § 702(b)(2)(B) ("The amendments made by sections 113 and 117 shall apply with respect to cases commenced under title 11 of the United States Code *before*, on, and after the date of the enactment of this Act.") (emphasis supplied).

Under § 106(a), as amended, sovereign immunity has been expressly abrogated as to contested claims like the instant claim, which IDOR seeks to have allowed under 11 U.S.C. § 502 and which, though late-filed, IDOR argues should be afforded priority under 11 U.S.C. § 507(a)(7). Amended § 106(b) expressly deems the filing of a proof of claim by a governmental unit to constitute a waiver of sovereign immunity with respect to any claim (like a § 362(a) violation) that is property of the estate and that arose out of the same "transaction or occurrence" out of which the government unit's claim arose.

IDOR cites to *Seminole Tribe of Florida v. Florida*, ___ U.S. ___, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996) in support of its proposition that the Court is precluded from redetermining Chandler's tax liability. Therein, the Court specifically held that the Indian Commerce Clause does

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of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

(c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

not grant Congress the power to abrogate states' sovereign immunity.[18] *Seminole* involved the Indian Gaming Regulatory Act (the "Act"),[19] which permitted an Indian tribe to conduct certain gaming activities within a state only if the tribe and the state first entered into a compact prescribing the conditions under which such activities would be conducted. The Act imposed on states a duty to negotiate with tribes in good faith in an attempt to form such pacts.[20] A tribe that believed a state had not negotiated in good faith could bring an action in federal court against that state.[21]

Pursuant to the Act, the Seminole Tribe brought suit against the State of Florida and its governor, alleging a failure to negotiate a gaming compact in good faith. The defendants moved to dismiss the action on the basis of sovereign immunity. The motion was denied. On interlocutory appeal, the Eleventh Circuit reversed the district court, holding that the action against both defendants was barred by the Eleventh Amendment.[22] The Supreme

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[18] The Court noted that no principled distinction can be drawn between the Indian Commerce Clause and the Interstate Commerce Clause. No discussion of the Bankruptcy Clause was made in the majority opinion, although it was referenced in Justice Stevens' dissent. *See* 116 S.Ct. at 1142.

[19] 25 U.S.C. § 2701 *et seq.*

[20] 25 U.S.C. § 2710(d)(3)(A).

[21] 25 U.S.C. § 2710(d)(7)(A)(i), (B)(i).

[22] The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. CONST. amend. XI.

Court affirmed the dismissal. The Court held that the Eleventh Amendment prevents Congress, acting pursuant to its Article I powers, from subjecting unconsenting states to suits brought by private parties in federal court. The Court also held that the governor and the State of Florida were immune from suit. The Court opined that Congress could not statutorily abrogate sovereign immunity for the states in the exercise of its Article I powers – even as to matters within the exclusive control of the federal government. Thus, the Court held that the Indian Gaming Regulatory Act's provision permitting tribes to sue unconsenting states in federal court was unconstitutional.

Next, IDOR cites to the Supreme Court's vacatur of *In re Merchants Grain, Inc.*, 59 F.3d 630 (7th Cir.1995), *vacated sub nom. Ohio Agric. Commodity Depositors Fund v. Mahern*, ___ U.S. ___, 116 S.Ct. 1411, 134 L.Ed.2d 537 (1996). IDOR contends that to the extent that *Seminole* left any question as to the applicability of its holding to Congressional abrogation of sovereign immunity under the Bankruptcy Clause, the issue was clarified when the Supreme Court granted certiorari in *Merchants Grain*, reversed the Seventh Circuit's decision, and remanded the case for further consideration in light of *Seminole*. In *Merchants Grain*, the Seventh Circuit permitted a bankruptcy trustee to maintain an action against an agency of the State of Ohio for the recovery of alleged preferential transfers.

IDOR contends that in light of *Seminole* and *Merchants Grain*, there are only two instances when a bankruptcy court would have jurisdiction over a proceeding involving a state. According to IDOR, the first instance

would be where federal jurisdiction is sought to enjoin a state official from engaging in an ongoing violation of state law under the doctrine set forth in *Ex parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908).[23] The second instance is where the state has waived its immunity by filing a claim. IDOR maintains that neither circumstance applies to the matter at bar.

IDOR does not dispute that the Court has jurisdiction to determine the allowance of its "responsible officer" claim against the Debtor. However, IDOR argues that its filing of a claim against the Debtor for responsible officer liability is separate and distinct from its claim against Chandler, and the filing of the responsible officer claim against the Debtor did not waive IDOR's sovereign immunity so as to allow the Court to redetermine Chandler's liability for the alleged use tax.

The Court holds that sovereign immunity does not bar the Court from redetermining Chandler's tax liability. The fact that IDOR's claim against Chandler and the Debtor are separate and distinct liabilities does not trigger sovereign immunity and the Eleventh Amendment. The matter at bar is a contested claim proceeding – a bankruptcy trustee's objection to a claim filed by a state agency. There is no action brought by the Trustee involuntarily forcing IDOR to unwillingly defend a motion or related adversary proceeding in this Court. IDOR voluntarily consented to the limited subject matter jurisdiction and the equitable powers of this Court and the claim

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[23] This matter does not seek to enjoin a state official from engaging in an ongoing violation of state law. Thus, *Young* is inapplicable to the matter at bar.

procedures under the Bankruptcy Code when it filed its proof of claim.

The Eleventh Amendment therefore plays no role in this objection to IDOR's late-filed claim. The issue in the cases cited by IDOR is the extent to which Congress is empowered to abrogate state sovereign immunity and allow suits against states. This present proceeding – an objection to a claim – is not the functional equivalent of a private party's suit against an unwilling state. The Court's determination of whether a state tax is owed does not implicate the Eleventh Amendment. *See Scheffel v. New York State Dept. of Taxation and Finance (In re Lehal Realty Assocs.)*, 133 B.R. 9, 12 (Bankr.S.D.N.Y.1991) ("In the absence of a demand for a money judgment against a state, the issue of sovereign immunity is not implicated because 11 U.S.C. § 505(a)(1) expressly authorizes this court to 'determine the amount or legality of any tax. . . . '"), *vacated*, 184 B.R. 205 (Bankr.S.D.N.Y.1993). Accordingly, the Court concludes that Eleventh Amendment sovereign immunity is not implicated in this contested claim proceeding because the Trustee makes no demand for a money judgment or other similar relief against IDOR.

Moreover, even if Illinois' sovereign immunity were implicated, the Court finds that IDOR has waived such sovereign immunity defense by filing proofs of claim in the Debtor's bankruptcy case. The majority of cases have held that filing a proof of claim waives the defense of sovereign immunity. *See, e.g., University Medical Center v. Sullivan (In re University Medical Center)*, 973 F.2d 1065, 1086 (3d Cir.1992); *995 Fifth Ave. Assocs., L.P. v. New York State Dept. of Taxation and Finance (In re 995 Fifth Ave. Assocs., L.P.)*, 963 F.2d 503, 509 (2d Cir.), *cert. denied*, 506

U.S. 947, 113 S.Ct. 395, 121 L.Ed.2d 302 (1992); *Sullivan v. Town & Country Home Nursing Servs., Inc. (In re Town & Country Home Nursing Servs., Inc.)*, 963 F.2d 1146, 1150 (9th Cir.1992); *Anderson v. Federal Deposit Ins. Corp.*, 918 F.2d 1139, 1143-44 (4th Cir.1990). By filing proofs of claim, IDOR has voluntarily submitted itself to the equitable jurisdiction of this Court, and coincidentally, has waived the right to have this matter tried before a jury. *See Langenkamp v. Culp*, 498 U.S. 42, 44-45, 111 S.Ct. 330, 331-32, 112 L.Ed.2d 343 (1990); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58-59, 109 S.Ct. 2782, 2799, 106 L.Ed.2d 26 (1989); *Katchen v. Landy*, 382 U.S. 323, 326, 86 S.Ct. 467, 470-71, 15 L.Ed.2d 391 (1966). These cases lead to the inevitable conclusion that when creditors voluntarily participate in a debtor's bankruptcy case by filing proofs of claim, they thereby consent to have their rights determined as against the bankruptcy estate, and to have the bankruptcy estate's rights determined as against them. If the constitutional right to trial by jury can be waived by the mere filing of the proof of claim, as noted in *Langenkamp, Granfinanciera,* and *Katchen,* so too can IDOR's defense of sovereign immunity. Such a defense is in essence an indirect challenge to the exercise of this Court's in personam jurisdiction. Creditors cannot pick and choose at will. Either they assert sovereign immunity and do not file proofs of claim, but stand suit properly asserting such defenses, as was done in *Leber v. Illinois Dept. of Revenue (In re Leber)*, 134 B.R. 911 (Bankr.N.D. Ill.1991), or as here, where IDOR effectively waived the immunity defenses and subjected itself to the Court's jurisdiction by filing proofs of claim.

IDOR counters that Chandler is not a debtor in bankruptcy and that IDOR has never filed a claim against Chandler for use tax liability in a bankruptcy case involving Chandler. Rather, as the argument goes, the Court would only have jurisdiction to redetermine IDOR's final assessment for use tax against Chandler if Chandler filed a bankruptcy petition, and if IDOR filed a claim in Chandler's bankruptcy case, it would waive its sovereign immunity. Instead, IDOR has filed claims in the Debtor's bankruptcy case, and thus, IDOR has not waived its sovereign immunity under the Eleventh Amendment to allow the Court to make a redetermination of Chandler's tax liability.

The Court also rejects this argument. First, as previously noted in the Opinion and Order of November 25, 1992, the Court found that the provisions of § 505(a)(1) allowed the Court to determine Chandler's tax liability. *See Stoecker*, 151 B.R. at 998-99. That point was affirmed by the District Court in its opinion. *See Stoecker*, 179 B.R. at 541. Thus, it is the law of the case and should be followed. Moreover, amended § 106(a)(1) expressly references § 505, showing Congressional intent to legislate abrogation of state sovereign immunity in matters within the scope and reach of § 505. Furthermore, the issue of the Debtor's alleged liability are related and linked to Chandler's alleged liability for non-payment of the assessed use tax. Although a corporate officer may be able to avoid personal liability for an unpaid Illinois use tax properly owed by a corporation by which the officer is claimed responsible, it defies logic to say such officer could be held so liable if in fact and in law the corporation is not liable for the claimed use tax. IDOR cannot

have it both ways and invoke the equitable powers of the Court under the Bankruptcy Code and file a claim to be paid out of the bankruptcy estate assets based on a derivative liability of the Debtor for his alleged willful failure to pay the claimed penalty, without implicating the possible defense that the underlying tax was improperly assessed against Chandler.

2. *The Sale of the Aircraft Was an "Isolated or Occasional Sale" Exempt From Tax*

The District Court specifically instructed this Court that if it "finds that the Debtor wilfully failed to pay the use tax assessed against Chandler, the Court must also make the finding that Chandler owed the assessed tax." *Stoecker*, 179 B.R. at 541. The Trustee argues that the tax upon which IDOR's proof of claim is based was never actually owed by Chandler because the sale of the Aircraft was exempt from the ROTA/use tax as an "isolated or occasional sale" under Ill.Rev.Stat., ch. 120, ¶ 439.2 (1989).[24] The basis for the "occasional sale" exemption is

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[24] Section 2 of ROTA provides that "a tax is imposed on persons engaged in the business of selling tangible personal property at retail. . . . " Section 1 of ROTA defines the "occasional sale" exemption as follows:

> The isolated or occasional sale of tangible personal property at retail by a person who does not hold himself out as being engaged (or who does not habitually engage) in selling such tangible personal property at retail . . . does not constitute engaging in a business of selling such tangible personal property at retail within the meaning of this Act. . . .

Ill.Rev.Stat., ch. 120, ¶ 440 (1989).

found in Section 3 of the Use Tax Act, Ill.Rev.Stat., ch. 120, ¶ 439.3 (1989).[25] The regulation adopted under the provisions of the Use Tax Act provides further insight:

> Any person who habitually engages in selling tangible personal property for use or consumption, or who, in any manner or at any time, advertises, solicits, offers for sale or holds himself out to the public to be a seller of tangible personal property for use or consumption . . . is engaged in the business that is taxed by this Act. . . .

Ill.Admin.Code tit. 86, § 130.115. Based on the statutory provisions and regulation, it is clear that for a person making sales of tangible personal property for use to be exempt from the application of ROTA as an "occasional seller," two conditions must be met. First, the seller must not habitually engage in the sale for use or consumption of the type of tangible property at issue. Second, the seller must not advertise, solicit, offer for sale, or hold himself out to the public as a seller of tangible personal property for use or consumption.

The Trustee argues that Chandler is not liable for the use tax on two theories. First, the Trustee contends that the sale of the Aircraft to Chandler was an "occasional

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[25] Section 3 of the Use Tax Act provides:

> If the seller of tangible personal property for use would not be taxable under the Retailers' Occupation Tax Act despite all elements of the sale occurring in Illinois, then the tax imposed by this Act shall not apply to the use of such tangible personal property in this State.

Ill.Rev.Stat., ch. 120, ¶ 439.3 (1989).

sale" exempt from use tax. Second, the Trustee states that although the title of the Aircraft was previously transferred from Bezwada, then to Opex Aviation, Inc., then to Jack Prewitt & Associates, who transferred it to Prewitt Leasing, who in turn sold the Aircraft to Chandler, for purposes of analyzing the tax consequences, the sale of the Aircraft should be viewed as a sale from Bezwada to Chandler, which the Trustee asserts, is exempt as an "occasional sale."

IDOR, on the other hand, argues that Jack Prewitt & Associates, a predecessor in the chain of title to the Aircraft, was a retailer of aircraft, and hence, the sale was taxable. IDOR maintains that because Jack Prewitt & Associates had been in title to the Aircraft and that title thereto was transferred from Jack Prewitt & Associates to Prewitt Leasing on the same day that Chandler purchased the Aircraft, the sale was not "isolated or occasional" because Jack Prewitt & Associates was a retailer of aircraft.

The evidence adduced on this issue was as follows: Jack Prewitt, president of Prewitt Leasing, testified that Prewitt Leasing, not Jack Prewitt & Associates, bought and owned the Aircraft and resold it to Chandler. (Jack Prewitt Dep. 29-30; Jack Prewitt Dep. Exhibit No. 9; IDOR's Exhibit No. 7). Prewitt Leasing, a company not engaged in the retail sale of aircraft, actually sold the Aircraft to Chandler. (Jack Prewitt Dep. 7). Jack Prewitt testified that title was inadvertently initially placed in Jack Prewitt & Associates, although it provided none of the funds used to purchase the Aircraft and received no part of the sales commissions. (Jack Prewitt Dep. 41-42, 56-57, 85-86). The error was attributed by Jack Prewitt to

his nephew, Raymond Prewitt, who had only recently joined Prewitt Leasing, and to an error by the salesman, who was having medical problems at the time and died shortly after the transaction. (Jack Prewitt Dep. 41). This error was discovered prior to the closing of the Aircraft sale, which occurred on September 30, 1988. (Jack Prewitt Dep. 101-02). Thus, at closing, title was transferred from Jack Prewitt & Associates to Prewitt Leasing to Chandler. (IDOR's Exhibit Nos. 6 and 7).

The Court finds that IDOR failed to introduce any evidence that Chandler or the Debtor knew that Jack Prewitt & Associates had been in title to the Aircraft, or that title to the Aircraft had been transferred from Jack Prewitt & Associates to Prewitt Leasing on the same day that Chandler purchased the Aircraft. The Court further finds that this error did not change the true character of the transaction – an "occasional sale" from a non-retailer, Prewitt Leasing to Chandler. Although a retailer, Jack Prewitt & Associates, through the above errors, held title to the Aircraft for a period of time, Prewitt Leasing was the party who actually purchase [sic] the Aircraft from Opex Aviation, Inc. and sold the Aircraft to Chandler, not Jack Prewitt & Associates.

Anderson offered an alternative analysis of the transaction, namely that it was really a sale from Bezwada to Chandler, with some intermediate title transfers that did not affect the substance of the transaction. (Tr. (Anderson) 128-29; Trustee's Exhibit No. 3). IDOR contends that the intervening transfers cannot be ignored and, even so, there was no evidence that Bezwada was not a retailer. Jack Prewitt described this type of transaction as a "back-to-back" transaction. (Jack Prewitt Dep. 111-12).

Although title passed through intermediate brokers, including Jack Prewitt & Associates, the sale was from Bezwada, a non-retailer, to Chandler. Anderson testified, without contradiction, that Bezwada "was not a dealer." (Tr. (Anderson) 128; Trustee's Exhibit No. 3 at 2).

Thus, the Court finds that the sale from Prewitt Leasing to Chandler qualifies as an "occasional sale" exempt from proper assessment of the Illinois use tax. Jack Prewitt testified that Prewitt Leasing purchased the Aircraft, that Prewitt Leasing leased and then sold the Aircraft to Chandler, and that Prewitt Leasing was in the leasing business, having sold only one aircraft prior to the transaction at issue. (Jack Prewitt Dep. 29-30, 76-77; Trustee's Exhibit No. 4; Jack Prewitt Dep. Exhibit No. 9 at 2, ¶ 4(d)); *see also* (Raymond Prewitt Dep. 11-13). IDOR has offered no contrary evidence.

3. ***The Court Will Not Disregard the Separate Legal Entities of Prewitt Leasing and Jack Prewitt & Associates and Thus Find That Prewitt Leasing Was Not an "Occasional" Seller of Aircraft***

IDOR further asserts that Prewitt Leasing and Jack Prewitt & Associates were integrated companies with common ownership and common employees and were acting in concert in selling the Aircraft to Chandler. Therefore, IDOR concludes that Prewitt Leasing acted in concert with Jack Prewitt & Associates, which regularly sold aircraft at retail, and hence, Prewitt Leasing cannot be considered an "occasional" seller with respect to the sale of the Aircraft to Chandler.

In effect, IDOR argues that the Court should pierce the corporate veils of Prewitt Leasing and Jack Prewitt & Associates, collapse these two corporations into one, and treat the latter as the seller of the Aircraft to Chandler. IDOR's mere allegation that Jack Prewitt & Associates and Prewitt Leasing are one entity does not, however, render Prewitt Leasing and Jack Prewitt & Associates as the same entity. The Court will not disregard the legal fiction of separate corporate entities and pierce a corporate veil without adequate supporting evidence.

The uncontroverted evidence is that Prewitt Leasing, not Jack Prewitt & Associates, acquired the Aircraft from Opex Aviation, Inc.[26] (Jack Prewitt Dep. 29-30). Jack Prewitt testified that Prewitt Leasing had the funds necessary to acquire the Aircraft. *Id.* Jack Prewitt & Associates did not. (Jack Prewitt Dep. 36, 58). Furthermore, the commission on the sale, $150,000, went entirely to Prewitt Leasing. Jack Prewitt & Associates received nothing. (Jack Prewitt Dep. 56-57).

It is true that Jack Prewitt Holding Company, another company associated with Jack Prewitt, filed consolidated tax returns, which included Jack Prewitt & Associates and Prewitt Leasing; that at times, Jack Prewitt & Associates and Prewitt Leasing advertised their services jointly; that

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[26] Jack Prewitt stated that Opex Aviation, Inc. only held naked title – it did not own the Aircraft. (Jack Prewitt Dep. 115-16). Prewitt speculated that Opex Aviation, Inc. held title because the Aircraft originated in Australia and needed to be titled to a United States entity prior to sale. *Id.*

occasionally Jack Prewitt & Associates and Prewitt Leasing referred customers to each other; that the two companies had common employees; and that they operated out of the same location. This does not demonstrate, especially in light of the other uncontroverted evidence, that Prewitt Leasing is a retailer of aircraft; nor does it prove that Jack Prewitt & Associates sold the Aircraft to Chandler.

Generally, Illinois law treats a corporation as a legal entity separate and distinct from other corporations or individuals with which it may be affiliated. *Main Bank of Chicago v. Baker*, 86 Ill.2d 188, 204, 56 Ill.Dec. 14, 21, 427 N.E.2d 94, 101 (1981); *Van Dorn Co. v. Future Chemical and Oil Corp.*, 753 F.2d 565, 569 (7th Cir.1985). The Illinois Supreme Court has recognized, however, that a corporate entity will be disregarded, and its veil of limited liability pierced, when two requirements are met: (1) there must be such a unity of interest and ownership that the separate personalities of the two corporations no longer exist; and (2) adherence to the fiction of separate corporate existence would sanction a fraud or promote an injustice. *Main Bank*, 86 Ill.2d at 205, 56 Ill.Dec. at 21, 427 N.E.2d at 101; *Van Dorn*, 753 F.2d at 569-70. Factors that the Illinois courts have considered in the determination of whether the first prong of the test has been met are: (1) the failure to maintain adequate corporate records or to comply with corporate formalities; (2) the commingling of funds or assets; (3) undercapitalization; and (4) one corporation treating the assets of another corporation as its own. *Main Bank*, 86 Ill.2d at 205-06, 56 Ill.Dec. at 22, 427 N.E.2d at 102.

IDOR has failed to present any evidence to demonstrate that there is a unity of interest and ownership between Jack Prewitt & Associates and Prewitt Leasing such that the separate juridical entities of the two corporations no longer exist. The mere fact that Jack Prewitt is president of both corporations and that they advertise together does not warrant disregarding the corporate entities as separate and distinct from one another. IDOR offered no evidence that the two corporations failed to maintain adequate corporate records or to comply with corporate formalities; that the corporations commingled funds or assets; that either corporation is undercapitalized; or that one corporation treats the assets of the other corporation as its own. Absent a showing of one or more of these factors, the Court will not pierce the corporate veil of Prewitt Leasing and collapse these two distinct corporations into one and find that the sale to Chandler was really made by Jack Prewitt & Associates.

The Court finds that Chandler's purchase of the Aircraft was a purchase from a non-retailer, with some intermediate title transfers that did not affect the substance of the transaction with another non-retailer. The Court finds that Prewitt Leasing owned the Aircraft at and prior to its sale to Chandler. (Jack Prewitt Dep. 29-30; Jack Prewitt Dep. Exhibit No. 9). Prewitt Leasing sold the Aircraft to Chandler. (IDOR's Exhibit No. 7; Jack Prewitt Dep. Exhibit No. 9). The sale of the Aircraft from Prewitt Leasing to Chandler was, therefore, an "occasional sale," exempt from Illinois use tax.

C. *Was the Debtor a Responsible Officer Who Willfully Failed to Pay the Use Tax Assessed Against Chandler?*[27]

The District Court held that this Court erred in finding that IDOR failed to meet its burden regarding whether the Debtor willfully failed to pay the tax assessed against Chandler. *Stoecker*, 179 B.R. at 541-44. The District Court held that IDOR's determination of a penalty due against a responsible individual, as evidenced by the NPL, establishes a prima facie case regarding all the statutory elements required for the imposition of such a penalty. *Id.* 544. The District Court noted that a taxpayer has better access to his or her records and witnesses to rebut the claim of willfulness. *Id.* Thus, the burden shifts to the Trustee to rebut the prima facie weight accorded the NPL. *Id.*[28]

1. *The Law of the Case Doctrine Prevents the Court From Not Considering the NPL as Prima Facie Evidence*

The law of the case doctrine requires a lower court judge to comply with the rulings made by higher courts

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[27] Notwithstanding the fact that the Court has determined that Chandler did not properly owe the assessed use tax, the Court nevertheless will address the issue of whether the Debtor's failure to pay the tax was willful. In the interest of completing the record and because the District Court specifically remanded this issue, the Court will decide same.

[28] As noted above, the NPL was not issued in violation of the automatic stay and is not void. The Trustee's argument that the NPL cannot constitute prima facie evidence in this case is therefore without merit.

in the same case. *See State of Arizona v. State of California*, 460 U.S. 605, 618, 103 S.Ct. 1382, 1391, 75 L.Ed.2d 318 (1983); *Cole Energy Dev. Co. v. Ingersoll-Rand Co.*, 8 F.3d 607, 609 (7th Cir.1993) (citations omitted). "[E]xplicit rulings on issues that were before the higher court and explicit directives by that court to the lower court concerning proceedings on remand are not dicta." *Id.* (citations omitted). The law of the case will not be enforced, however, where it is clearly erroneous or where doing so would produce an injustice. *Redfield v. Continental Casualty Corp.*, 818 F.2d 596, 605 (7th Cir.1987) (citations omitted). Previously decided determinations are not applied if there are reasons rendering the doctrine inapplicable, such as: (1) substantial new evidence introduced after the first review; (2) a decision of the United States Supreme Court after the first review; or (3) a conviction on the part of the second reviewing court that the decision of the first was clearly erroneous. *Key v. Sullivan*, 925 F.2d 1056, 1060 (7th Cir.1991) (citation omitted); *Parts and Elec. Motors, Inc. v. Sterling Elec. Inc.*, 866 F.2d 228, 231 (7th Cir.1988), *cert. denied*, 493 U.S. 847, 110 S.Ct. 141, 107 L.Ed.2d 100 (1989).

In remanding the case, the District Court held that "[t]he NPL *shall* be considered prima facie proof of the Debtor's willfulness which the Trustee will have the burden to rebut. . . . After hearing all the evidence offered by the parties, the Bankruptcy Court should determine whether the Trustee successfully proved that the Debtor's inaction was not willful." *Stoecker*, 179 B.R. at 544 (emphasis supplied). The District Court found that the NPL constituted prima facie proof of all elements of

responsible officer liability including the element of willfulness, and that the burden was on the Trustee to establish that the Debtor's failure to pay the tax was not willful.

The Court finds and concludes that it is bound to follow the District Court's directive. There has been no substantial new evidence introduced to this Court after the District Court's decision; no decision of the United States Supreme Court has been rendered that deals with the issues at bar; and this Court does not possess a conviction that the decision of the District Court was clearly erroneous.[29] The District Court clearly held that the NPL shall be considered prima facie evidence of the Debtor's willfulness. *Stoecker*, 179 B.R. at 544. Accordingly, the Court will discuss whether the Trustee introduced evidence sufficient to adequately demonstrate that the Debtor's failure to pay IDOR pursuant to the NPL was not willful, thereby successfully rebutting the presumption of willfulness.

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[29] While this Court respectfully disagrees with some of the District Court's conclusions, this Court is not willing to make a determination that same were clearly erroneous, notwithstanding this Court's opinion that its findings and conclusions contained in its Opinion and Order dated November 25, 1992 were correct and represent the better view of the matter. *See Stoecker*, 151 B.R. 989. Rather, the Court acknowledges the hierarchy in the federal judiciary from which flows the doctrines of law of the case and stare decisis – two doctrines which the Court believes it must and should follow.

2. *Applicable Statutes and Case Law Regarding Responsible Officer Liability*

IDOR argues that the evidence clearly shows that the Debtor's failure to pay the use tax was, at the very least, a reckless disregard for a known risk of violation and therefore was willful. The Trustee, on the other hand, contends that the evidence, namely the opinion letter by Anderson, indicates that the transaction was an occasional sale and thus not taxable. The Trustee further submits that the representations of the seller demonstrate that the Aircraft purchase was properly claimed exempt from the use tax. The Trustee further argues that even if Anderson's opinion letter and the representations made to Chandler from the seller were incorrect, the Debtor's reliance on same negates any inference of willfulness on his part.

Section 13½ of the Retailers' Occupation Tax Act ("ROTA") provides that a responsible individual may be liable for taxes under certain circumstances when a corporate taxpayer fails to pay the taxes.[30]

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[30] Section 13½ of ROTA provides in relevant part:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax here imposed . . . and who willfully fails to file such return or to make any such payment to [IDOR] or who willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon. . . .

Ill.Rev.Stat., ch. 120, ¶ 452½ (1991).

In *Branson v. Department of Revenue*, 168 Ill.2d 247, 213 Ill.Dec. 615, 659 N.E.2d 961 (1995), decided after the Court's Opinion and Order dated November 25, 1992, the Illinois Supreme Court defined the willful failure to pay taxes for purposes of Section 13½ of ROTA as involving "intentional, knowing and voluntary acts" or, alternatively, "reckless disregard for obvious or known risks" which includes "gross negligence involving a known risk of violation." 168 Ill.2d at 255, 213 Ill.Dec. at 620, 659 N.E.2d at 965; *see also Department of Revenue v. Heartland Invs., Inc.*, 106 Ill.2d 19, 29, 86 Ill.Dec. 912, 917, 476 N.E.2d 413, 418 (1985); *Department of Revenue v. Joseph Bublick & Sons, Inc.*, 68 Ill.2d 568, 577, 12 Ill.Dec. 265, 269, 369 N.E.2d 1279, 1283 (1977) ("a voluntary, conscious and intentional failure satisfies the requirements of 'wilfully fail' "). Willfulness is determined by whether (1) the Debtor knew the tax was due and (2) nonpayment of the tax resulted from the voluntary, conscious, and intentional failure to pay by the Debtor. *See Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 583-85, 133 Ill.Dec. 647, 650, 541 N.E.2d 858, 861 (4th Dist.1989); *Department of Revenue v. Marion Sopko, Inc.*, 84 Ill.App.3d 953, 955-56, 40 Ill.Dec. 487, 488, 406 N.E.2d 188, 189 (2d Dist.1980). *See also People ex rel. Dept. of Revenue v. National Liquors Empire, Inc.*, 157 Ill.App.3d 434, 439, 109 Ill.Dec. 627, 631, 510 N.E.2d 495, 499 (4th Dist.1987). ("A person must have knowledge to voluntarily, consciously and intentionally fail to file and pay the correct amount of taxes due.").

To establish that the Debtor was a responsible party, the requisite inquiry under ROTA is whether the Debtor had "control, supervision or responsibility for filing

returns and making payment of the amount of tax herein imposed. . . . " Ill.Rev.Stat., ch. 120, ¶ 452½ (1991).

3. *The Evidence Did Not Show That the Debtor Had Control, Supervision, or Responsibility for Filing Returns and Making Payment of the Tax Allegedly Owed By Chandler*

The Trustee argues that IDOR offered no evidence that the Debtor was in control, or had the supervision or responsibility over Chandler's payment of taxes within the meaning of ROTA. The Trustee contends that all of the evidence demonstrated that Pluhar, not the Debtor, was in charge of the day to day operations and financial responsibilities of Chandler. Thereby, the Trustee maintains that he has submitted substantive evidence rebutting the prima facie effect of the NPL.

The Trustee introduced evidence that Pluhar was the Chandler officer responsible for the payment of Chandler's bills and taxes. Anderson, counsel for Chandler, testified that Pluhar functioned as the Debtor's chief financial officer. (Tr. (Anderson) 131). Anderson discussed with Pluhar the "potential tax ramifications of the sale [of the Aircraft]." (Tr. (Anderson) 134). Anderson also testified that in addition to Pluhar, he dealt with George Weiler on behalf of Chandler, not with the Debtor. (Tr. (Anderson) 125). Pluhar signed the Aircraft Purchase Agreement (Jack Prewitt Dep. Exhibit No. 9 at 5), and was the person from Chandler with the most involvement in the purchase. (Jack Prewitt Dep. Exhibit No. 14). There is no direct evidence, however, linking the Debtor to

Chandler's day to day operations and the payment of its bills and taxes in the course of its business.

IDOR offered evidence that the Debtor was the president and a director of Chandler. (IDOR's Exhibit No. 19). Based on this evidence, IDOR summarily concludes that the Debtor was the responsible party. Further, IDOR points to the Aircraft Lease/Purchase Agreement, which was signed by the Debtor. (Jack Prewitt Dep. Exhibit No. 3 at 10).

The Seventh Circuit in *Monday v. United States*, 421 F.2d 1210 (7th Cir.), *cert. denied*, 400 U.S. 821, 91 S.Ct. 38, 27 L.Ed.2d 48 (1970) has held, however, that holding corporate office, alone, is insufficient to establish responsible party liability.

> Corporate office does not, *per se*, impose the duty to collect, account for and pay over the withheld taxes. On the other hand, an officer may have such a duty even though he is not the disbursing officer. . . . Liability attaches to those with power and responsibility within the corporate structure for seeing that the taxes withheld from various sources are remitted to the Government. . . . This duty is generally found in high corporate officials charged with general control over corporate business affairs who participate in decisions concerning payment of creditors and disbursal of funds.

Id. at 1214-15 (determination of responsible party liability under Internal Revenue Code) (citations omitted).[31] Other

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[31] Illinois case law recognizes that reference to analogous federal case law interpreting the federal responsible officer

courts have likewise held that the authority of a corporate officer alone is insufficient to establish responsible party liability. *See In re Premo*, 116 B.R. 515, 525 (Bankr.E.D.Mich.1990) (responsible party liability under Internal Revenue Code).

The Seventh Circuit addressed "responsible person" liability within the meaning of Section 6672 of the Internal Revenue Code, a provision somewhat analogous to Section 13½ of ROTA, in *United States Internal Revenue Service v. Charlton*, 2 F.3d 237 (7th Cir.1993). In order to determine whether a person is a "responsible person" within the meaning of Section 6672, the Seventh Circuit opined:

> Whether such a duty exists depends on whether the taxpayer has "significant control or authority over an enterprise's finances or general decision-making." Relevant factors include the holding of an entrepreneurial stake in a company, the holding of corporate office, the authority to disburse funds on behalf of the company, the ability to take out loans on behalf of the company and the ability to hire and fire employees. The true objective of this inquiry, and the sine qua non of liability under section 6672, is a determination that the taxpayer had the authority to allocate funds to pay the company's other debts in preference to its debt to the IRS.

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statute is appropriate in interpreting the responsible officer provisions of ROTA. *See Branson*, 168 Ill.2d at 261-62, 213 Ill.Dec. at 622, 659 N.E.2d at 968; *Heartland*, 106 Ill.2d at 29-30, 86 Ill.Dec. at 916-17, 476 N.E.2d at 417-18.

Id. at 240 (citations omitted). *See also In re Tripplett*, 115 B.R. 955, 963-64 (Bankr.N.D.Ill.1990). In *Charlton*, the court found evidence that the defendant held a substantial entrepreneurial stake in the companies; he was a member of the boards of directors of all of the corporations, and secretary of several of them. 2 F.3d at 240. Further, the defendant had the authority to borrow money on behalf of the corporations and to disburse the companies' funds. *Id.* The court specifically rejected the defendant's argument that while he had the titular authority to disburse the corporations' funds, he had delegated that responsibility to others. *Id.* The court noted that delegation of disbursal authority does not relieve the delegator of liability. *Id.* (citation omitted). The court stated that "a corporate president who relies on others for routine calculation and payment of taxes *may* also be held liable." *Id.* (citation omitted and emphasis supplied).

The Court finds that IDOR failed to introduce sufficient evidence to adequately prove that the Debtor had actual control, supervision, or responsibility for making payment of the tax allegedly owed by Chandler. The mere fact that the Debtor was the president of Chandler did not ipso facto impose upon him the duty of paying Chandler's taxes or being the responsible officer for paying Chandler's various bills. The limited evidence adduced showed that Pluhar, not the Debtor, was responsible for and in control of Chandler's finances. IDOR failed to introduce any evidence that the Debtor in fact exercised any authority or controlled the payment of Chandler's taxes. The Court is not willing without more, however, to equate potential authority with de facto or de

jure duty. The logical conclusion of IDOR's argument seems to be that the Debtor, by virtue of his status as president, director, and shareholder of Chandler, was in control of Chandler's payment of expenses and taxes. The Court is unwilling to functionally relegate the Debtor to becoming a personal guarantor of the claimed unpaid taxes assessed against Chandler without any evidence to show that the Debtor was actually in control of Chandler's financial affairs.

As the Court previously stated, the Court can reasonably infer that the Debtor, as such officer and director, had ultimate general control of Chandler's affairs. *See Stoecker*, 151 B.R. at 1000. Anderson's testimony that he dealt primarily with Pluhar and Weiler while representing Chandler (Tr. (Anderson) 125, 131, and 134) does not establish that the Debtor in fact exercised any authority or control to determine whether taxes should be paid. As president of Chandler, the Debtor certainly held an entrepreneurial stake in Chandler, and he may have possessed the potential authority to disburse funds on behalf of the company, and may have had the ability to take out loans on behalf of Chandler, or the ability to hire and fire employees. However, there was no testimony that the Debtor exercised any authority or power to determine whether taxes should be paid. What is lacking here is any evidence to show any actual exercise of control by the Debtor as summarily concluded by IDOR. Mere status as a corporate officer is insufficient to subject a debtor to the responsible person liability. There must be some evidence of actual control, supervision, or responsibility.

The Court finds that IDOR's NPL, together with the Debtor's status as corporate officer, director, and shareholder does not establish that the Debtor exercised control over Chandler's finances and payment of its taxes. Rather, the evidence leads the Court to conclude that he delegated such authority and power to Pluhar. Because there is no evidence before the Court to show that the Debtor had control, supervision, or responsibility for the payment of Chandler's taxes, there can be no finding that the Debtor took any action that can be construed as voluntary, conscious, and intentional or in reckless disregard with respect to any failure to pay assessed taxes.

4. *The Debtor's Failure to Pay the Tax Was Not Shown To Be Voluntary, Conscious, and Intentional*

Even if the Debtor was in control, or had the supervision or responsibility for filing tax returns and making payment of taxes owed by Chandler, the Court will next address whether the Debtor's actions in failing to pay the assessed use tax were voluntary, conscious, and intentional. The evidence adduced demonstrated the following:

Anderson's opinion letter was supported by the "Certificate Re Occasional Seller Exemption from Illinois Sales and Use Tax" signed by Prewitt Leasing's vice president on September 30, 1988. (Trustee's Exhibit No. 4; Tr. (Anderson) 132). Anderson never issued the opinion letter to Chandler or any of its officers. Nevertheless, Anderson gave Pluhar a copy of the legal opinion letter.

(Tr. (Anderson) 130-31). The accuracy of the representations contained in the Certificate and the Aircraft Purchase Agreement were confirmed by the president of Prewitt Leasing, Jack Prewitt. (Jack Prewitt Dep. 3-4, 76-77; Prewitt Dep. Exhibit No. 9 at 2, ¶ 4(d)) ("Prewitt [Leasing] is not a manufacturer of aircraft or a dealer or distributor of aircraft. . . . "). Anderson discussed the tax implications of the Aircraft purchase with Pluhar. Anderson testified that Pluhar stated: "This transaction is really an occasional sale. You're buying this aircraft from Bezwada, but with all of these interbreeding transfers, you've muddied the waters here; and if, you know, that because of all these transfers, [IDOR] could construct an argument that the tax is due." (Tr. (Anderson) 134). Anderson replied: "I don't think a tax is due but you've got to understand that because of these transfers it's not as clear cut as it was when – if you just gave the money to Bezwada and took title to the [A]ircraft." (Tr. (Anderson) 135).

IDOR argues that the Trustee provided no evidence that the Debtor actually relied on Anderson's letter to NEMLC in not paying the tax. IDOR contends that the Trustee is asking the Court to infer reliance. IDOR maintains that such an inference is not proper for two reasons: (1) other evidence suggests that Chandler and the Debtor attempted to avoid the issue of whether tax was due on the purchase of the Aircraft by failing to file a use tax return, even one that claimed the purchase to be exempt, and Chandler did not register the Aircraft with the Illinois Department of Transportation Division of Aeronautics as required by Ill.Rev.Stat., ch. 15 1/2, ¶ 22.42 (1989); and (2) Anderson did not issue a similar legal opinion to

Chandler or the Debtor, and Anderson never sought a private letter ruling from IDOR on the issue of taxability of the sale. Thus, IDOR contends that to infer reliance by the Debtor on Anderson's letter in these circumstances would be improper.

The evidence suggests, however, that Pluhar, as corporate financial officer of Chandler, was responsible for the payment of taxes and other debts of the corporation. Thus, to the extent that the Debtor was in control of this function at all, he was acting through Pluhar, as his agent.

In Illinois, an agency is a consensual fiduciary relationship between two legal entities whereby the principal has the right to control the conduct of the agent and the agent has the power to effect the legal relations of the principal. *Greenfield Direct Response, Inc. v. ADCO List Management (In re Greenfield Direct Response, Inc.)*, 171 B.R. 848, 855 (Bankr.N.D.Ill.1994) (citations omitted). The key consideration in determining whether an agency relationship exists is whether the principal had the right to control the activities of the agent. *Oberlin v. Marlin American Corp.*, 596 F.2d 1322, 1326 (7th Cir.1979). Although existence of an agency relationship is a question of fact, it may be inferred from facts of a particular case. *Greenfield*, 171 B.R. at 855 (citations omitted). An agency relationship can be inferred from circumstantial evidence, including the situation occupied by the parties, their acts, and other relevant circumstances. *City of Evanston v. Piotrowicz*, 20 Ill.2d 512, 518, 170 N.E.2d 569, 573 (1960). To bind the principal, the agent must have either actual authority, apparent authority, or the principal must ratify the agent's actions. *Anetsberger v. Metropolitan Life Ins. Co.*, 14 F.3d 1226, 1234 (7th Cir.1994).

To the extent, if any, that the Debtor was in control of paying any taxes, the Court will infer an agency relationship between the Debtor and Pluhar. As an agent of the Debtor, Pluhar had the authority to bind the Debtor.

Furthermore, the Court finds that Pluhar, as the agent of the Debtor, reasonably relied on the legal opinion of Anderson supported by the Certificate from the seller. Reasonable reliance by a corporate officer on advice of his attorney or accountant in not paying a tax can obviate a finding of willfulness. *See Gray Line Co. v. Granquist*, 237 F.2d 390, 395 (9th Cir.1956) (refusing to find officer acted willfully where he relied on advice of competent counsel and tax collector that no tax was due), *cert. denied*, 353 U.S. 911, 77 S.Ct. 667, 1 L.Ed.2d 664 (1957); *Corrosion Systems*, 185 Ill.App.3d at 583-84, 133 Ill.Dec. at 650, 541 N.E.2d at 861 (holding that officer's reliance on accountant negated a finding that he acted consciously, voluntarily, intentionally, knowingly, or recklessly in his failure to pay tax). IDOR argues that there was no evidence submitted that the Debtor relied on Anderson's opinion letter, which was issued to NEMLC. The mere fact that the opinion letter was addressed to NEMLC, Chandler's lender, does not ipso facto mean that the Debtor would not have been able to rely upon the letter. After all, Anderson was counsel to Chandler, not NEMLC. (Trustee's Exhibit No. 3; Tr. (Anderson) 124-25).

The evidence submitted demonstrated that Pluhar, the individual officer responsible for Chandler's finances, (Tr. (Anderson) 131), did review Anderson's letter and had a discussion with Anderson regarding the potential taxability of the Aircraft purchase. The Court finds that Pluhar, as the officer responsible for Chandler's finances,

reasonably relied on this advice. Furthermore, because Pluhar was an agent of the Debtor, to the extent that the Debtor was in control at all, this reasonable reliance is imputed to the Debtor as principal.

Accordingly, the Court finds that the Debtor, through his agent Pluhar, relied on the opinion letter in deciding not to pay the use tax assessed against Chandler. Hence, the Debtor's reliance on this opinion letter negates a finding that he acted consciously, voluntarily, intentionally, knowingly, or recklessly in his failure to pay the assessed tax.

Additionally, the Court finds that Anderson's failure to seek a private letter ruling from IDOR that the sale of the Aircraft was not taxable does not prevent the Court from finding that the Debtor, through Pluhar, reasonably relied on Anderson's legal opinion letter. Even if the legal opinion and representations by the seller were incorrect, same negate any presumption that the Debtor acted willfully in failing to pay the tax. The Court therefore holds that the totality of the evidence does not demonstrate that the Debtor's failure to pay the tax showed a "gross negligence involving a known risk of violation" and was therefore willful.

5. *The Court Will Not Draw Any Inferences From the Debtor's Invocation of the Fifth Amendment Privilege*

There is no direct evidence that the Debtor had control in this situation or that he relied on Anderson's opinion letter because in response to questioning in this

matter, the Debtor asserted his Fifth Amendment privilege. IDOR argues that the Court should construe the Debtor's silence against him in making a determination of whether the Debtor's failure to pay the tax was willful. Specifically, IDOR maintains that it is properly entitled to rely on the negative inference arising from the Debtor's assertion of the Fifth Amendment privilege to the question of whether he actually relied on advice of counsel when he failed to pay the use tax.[32]

The Supreme Court in *Baxter v. Palmigiano*, 425 U.S. 308, 96 S.Ct. 1551, 47 L.Ed.2d 810 (1976) stated that "the Fifth Amendment does not forbid inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them: the Amendment 'does not preclude the inference where the privilege is claimed by a party to a Civil cause.' " *Id.* at 318, 96 S.Ct. at 1558 (citation omitted). In *Baxter*, an inmate of a Rhode

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[32] IDOR cites several cases in support of this proposition. *See Cerro Gordo Charity v. Fireman's Fund American Life Ins. Co.*, 819 F.2d 1471 (8th Cir.1987); *RAD Services, Inc. v. Aetna Casualty & Surety Co.*, 808 F.2d 271 (3d Cir.1986); *Brink's Inc. v. City of New York*, 717 F.2d 700 (2d Cir.1983). None of these cases are controlling or directly on point. The matter at bar does not involve a situation in which one of the litigants asserts a Fifth Amendment privilege relating to matters within the scope of his prior employment or board responsibilities. The Debtor is not a party to the instant contested claim. IDOR is the party claimant and the Trustee is the party objector. Moreover, this is not a case in which a conspirator has asserted his Fifth Amendment privilege in a case against his co-conspirator. *See United States v. District Council of New York and Vicinity of United Bhd. of Carpenters and Joiners of America*, 832 F.Supp. 644 (S.D.N.Y.1993); *Aetna Casualty & Surety Co. v. Rodco Autobody*, 138 F.R.D. 328 (D.Mass.1991).

Island prison was charged in a disciplinary proceeding with inciting a disturbance of prison operations. At a hearing in which he was told that he had the right to remain silent, but that if he did so, his silence would be used against him, the prisoner remained silent when faced with incriminating evidence. *Id.* at 312, 96 S.Ct. at 1555. The prison board placed the prisoner in segregation for thirty days and downgraded his institutional status. *Id.* at 313, 317, 96 S.Ct. at 1955-56, 1557. In *Lefkowitz v. Cunningham*, 431 U.S. 801, 97 S.Ct. 2132, 53 L.Ed.2d 1 (1977), the Supreme Court characterized the *Baxter* holding in this way:

> Baxter did no more than permit an inference to be drawn in a civil case from a party's refusal to testify. Respondent's silence in *Baxter* was only one of a number of factors to be considered by the finder of fact in assessing a penalty, and was given no more probative value than the facts of the case warranted; here, refusal to waive the Fifth Amendment privilege leads automatically and without more to imposition of sanctions.

Id. at 808 n. 5, 97 S.Ct. at 2137 n. 5.

The rule that adverse inferences may be drawn from Fifth Amendment silence in civil proceedings has been recognized by the Seventh Circuit. *See, e.g., Daniels v. Pipefitters' Ass'n Local Union No. 597*, 983 F.2d 800, 801-02 (7th Cir.1993); *National Acceptance Co. of America v. Bathalter*, 705 F.2d 924, 929-30 (7th Cir.1983). The inference against a witness that may be drawn from the invocation of the Fifth Amendment in a civil action is permissive. *Daniels*, 983 F.2d at 802. The language in *Baxter* indicates that the inference is not required; it may be drawn, but it

does not necessarily need to be drawn. *Daniels*, 983 F.2d at 802. Thus, although the Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them, an analysis of that evidence is nonetheless required.

The adverse inference that may be drawn when a party asserts the Fifth Amendment privilege is not a substitute for proof and cannot fill an evidentiary void. *See United States v. Rylander*, 460 U.S. 752, 758, 103 S.Ct. 1548, 1553, 75 L.Ed.2d 521 (1983). "Silence is a relevant factor to be considered in light of the proffered evidence, but the direct inference of guilt from silence is forbidden." *LaSalle Bank Lake View v. Seguban*, 54 F.3d 387, 390 (7th Cir.1995); *see also Bathalter*, 705 F.2d at 927-28 (failure to answer the allegations of a civil complaint based on the assertion of Fifth Amendment privilege cannot be construed as an admission).

The Court will not construe the Debtor's silence or invocation of the Fifth Amendment as an admission of his willfulness not to pay the assessed tax. To do so would constitute a substitute for proof and fill an evidentiary void. The Debtor is not a party to this contested claim and has never been involved in this matter. Rather, in objecting to IDOR's claim, the Trustee acts as the statutory representative of the Debtor's creditors. *Baxter* does not mandate an adverse inference against the Trustee in this claim objection proceeding wherein the Debtor has invoked the Fifth Amendment privilege. The Court declines to draw any inference whatsoever in this matter from the Debtor's timely and proper invocation of his Fifth Amendment privilege. The Debtor is currently

under indictment for federal bank fraud and other charges, and is awaiting trial in the District Court. Some of the charges relate to his involvement with Chandler. Hence, the Debtor's invocation of the Fifth Amendment is both understandable and proper.

To draw an adverse inference against the Trustee based upon the Debtor's invocation of the Fifth Amendment would unfairly prejudice the Trustee as well as the creditors of the Debtor's estate by punishing them for the Debtor's attempt to shield himself from criminal liability. In *Libutti v. United States*, 894 F.Supp. 589 (N.D.N.Y.1995), the court refused to draw an adverse inference in a tax suit against a litigant because of her father's assertion of the Fifth Amendment privilege. The court reasoned that:

> The government has not provided any cases in which a non-party witness' invocation of his Fifth Amendment privilege has resulted in drawing an adverse interest [sic] against a party where the non-party witness was not in some way a former member or employee of the party at issue. Additionally, the Second Circuit has held in a case where a non-party, who did not have a former member or employee relationship with the party at issue, invoked his Fifth Amendment privilege that "no adverse interest [sic] against appellees could have been drawn by his refusal to testify." *Brenner v. World Boxing Council*, 675 F.2d 445, 454 n. 7 (2d Cir.1982). Thus, the court in this case, refuses to draw an adverse inference against Edith LiButti because of Robert LiButti's assertion of his Fifth Amendment privileges.

Id. at 597.[33] The Court will not undercut the limited protection provided by the Fifth Amendment and effectively impose a civil penalty by making an adverse finding against the Debtor's bankruptcy Trustee or the estate for the Debtor's silence.

The Debtor has not cooperated with either the Trustee or IDOR in this matter. It is undisputed that neither side has an unfair advantage over the other or has suffered any remediable disadvantage because the Debtor has refused to cooperate with either party. The Debtor's failure to cooperate has not prevented effective cross-examination because neither party to this contested claim has had an opportunity to directly examine the Debtor. The Court, as the fact finder, is fully aware of the Debtor's invocation of the Fifth Amendment privilege. The Court has chosen, in its discretion, not to draw any inferences either against or for the Trustee or IDOR because of the Debtor's invocation of this privilege. The Court is not required to draw any inferences from the Debtor's invocation of the Fifth Amendment privilege. *See, e.g., Old Security Life Ins. Co. v. Continental Illinois Nat. Bank & Trust Co. of Chicago*, 740 F.2d 1384, 1398 (7th Cir.1984).

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[33] The Trustee argues that the only evidence offered by IDOR of the Debtor's willfulness is the allegedly invalid NPL (invalid because it was allegedly issued in violation of the automatic stay). However, as already noted above, the NPL did not violate the automatic stay, and therefore is not void. The District Court has already found the NPL constitutes prima facie proof of the Debtor's willfulness. Furthermore, IDOR has submitted other evidence of the Debtor's willfulness.

6. *The Use Tax Allegedly Owed By Chandler Arose on September 30, 1988*

Additionally, IDOR argues that the Debtor could not have relied on Anderson's opinion letter, which is dated September 30, 1988, because the alleged use tax arose on June 7, 1988, the date Chandler entered into the Aircraft Lease/Purchase Agreement.

IDOR correctly points out that the District Court, in remanding this matter, stated that the Court had discretion to reopen the proofs so that both parties could introduce additional evidence. *See Stoecker*, 179 B.R. at 544. IDOR states that it is not estopped from arguing that the taxable sale took place on June 7, 1988, in light of the new evidence introduced. IDOR contends that evidence was presented to the Court on April 29, 1996 in the form of depositions and exhibits that indicate the sale took place on June 7, 1988.

IDOR posits that this issue is important to the determination of this matter for two reasons. First, if Prewitt Leasing (assuming Prewitt Leasing was the party purchasing the Aircraft from Opex Aviation, Inc./Bezwada), purchased the Aircraft with the intention of leasing it to Chandler, Prewitt Leasing and not Chandler would be deemed the "user" for purposes of the Use Tax Act and Prewitt Leasing would have been the party responsible for the tax. If, however, Prewitt Leasing purchased the Aircraft for the purpose of resale, and the Aircraft Lease/Purchase Agreement is found to be a conditional sale, Chandler would be liable for the use tax at the time it entered into the Aircraft Lease/Purchase Agreement and took delivery of the Aircraft on June 7, 1988, unless the

sale is deemed an "occasional" sale. The second reason the date issue is important pertains to the Debtor's willfulness because IDOR asserts that the issue of willfulness is determined at the time the tax is incurred.

The evidence in the record shows that Anderson formulated his opinion before September 30, 1988, and discussed the tax aspects of the transaction with counsel for NEMLC and with Pluhar prior to September 30, 1988. (Tr. (Anderson) 125-26, 132, and 134). Moreover, the Court finds that the sale of the Aircraft to Chandler took place on September 30, 1988, not June 7, 1988. Several facts in evidence support this finding. First, the Aircraft Purchase Agreement between Prewitt Leasing and Chandler is dated September 30, 1988. (Jack Prewitt Dep. Exhibit No. 9). That agreement is fully integrated and provides:

> (b) This Agreement constitutes the entire understanding of the parties relating to the subject matter thereof, and supercedes all prior representations and agreements, written or oral, relating to the subject matter hereof.

Id. at 4. Second, the NPL upon which IDOR relies asserts that the Aircraft was purchased in September 1988. (IDOR's Exhibit No. 1). In addition, the NTL sent to Chandler also references September 1988 as the date Chandler purchased the Aircraft. (IDOR's Exhibit No. 10 at 2 and 5). Furthermore, the Aircraft bill of sale also shows that the Aircraft was purchased by Chandler on September 30, 1988. (IDOR's Exhibit No. 7). Finally, IDOR's proof of claim indicates a sale date of September 1988. (IDOR's Exhibit No. 17). Both this Court and the District Court found, based on the evidence submitted by

IDOR, that the Aircraft was sold to Chandler on September 30, 1988. *See Stoecker,* 151 B.R. at 992; *Stoecker,* 179 B.R. at 534.

7. *The Aircraft Lease/Purchase Agreement Between Chandler & Prewitt Leasing Was Not a Disguised Conditional Sale*

IDOR's argument that the Aircraft Lease/Purchase Agreement was really entered into between Prewitt Leasing and Chandler on June 7, 1988 when Chandler took delivery of the Aircraft on that same date, and the Lease/Purchase Agreement with option to buy was really a disguised conditional sale or security agreement and that it therefore gave rise to use tax liability, is likewise without merit. At his deposition, Jack Prewitt testified that the Aircraft was purchased for the purpose of reselling it to Chandler. (Jack Prewitt Dep. 24). Further, Jack Prewitt authenticated the Aircraft Lease/Purchase Agreement as the operative agreement pursuant to which Chandler took delivery of the Aircraft. (Jack Prewitt Dep. 51-52). Additionally, he testified that when Chandler "purchased" the Aircraft on September 30, 1988, it was exercising its buy out option pursuant to the Aircraft Lease/Purchase Agreement. (Jack Prewitt Dep. 66-67).

IDOR argues that the Aircraft Lease/Purchase Agreement required Chandler to pay a security deposit of $2,455,016 of which $2,405,016 could be applied to the buy out option price of $12,405,016. (Jack Prewitt Dep. Exhibit No. 3). The amount of additional funds needed by Chandler to exercise the buy out option was $10 million. According to IDOR, this $10 million was much less than

the appraised value of the Aircraft which was $12.5-12.7 million. IDOR concludes that the amount required to exercise the buy out option under the lease was substantially less than the fair market value of the property, thus, the lease should be deemed a conditional sale and not a true lease with an option to buy later exercised in September 1988 by Chandler.

To determine whether an agreement that purports to be a lease is a true lease or a security agreement, the Court must look to state law. *Powers v. Royce Inc. (In re Powers)*, 983 F.2d 88, 90 (7th Cir.1993) ("Ordinarily the existence, nature and extent to a security interest in property is governed by state law."). Arguably, the Federal Aviation Act, 49 U.S.C. § 40101 *et seq.* ("FAA"), applies. However, it is not necessary for this decision to determine whether the FAA, which creates a federal recording scheme, preempts the definition of a conditional sales contract.[34]

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[34] FAA creates, *inter alia*, a national recording scheme for air commerce. Most courts have held that although the FAA operates to determine whether a valid recording has occurred, in most other aspects of secured transactions it does not preempt state law. *See, e.g., Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1278 (8th Cir.1988) (holding that FAA does not preempt state law when determining date of perfection); *Gary Aircraft Corp. v. General Dynamics Corp. (In re Gary Aircraft Corp.)*, 681 F.2d 365, 372 (5th Cir.1982) (holds that FAA does not displace state law assignment of priorities to interests in aircraft), *cert. denied*, 462 U.S. 1131, 103 S.Ct. 3110, 77 L.Ed.2d 1366 (1983); *Danning v. World Airways, Inc. (In re Holiday Airlines Corp.)*, 647 F.2d 977, 980 (9th Cir.1981) (holds that FAA merely preempts validity of recording as against third parties; failure to record with FAA did not invalidate lien as against debtor), *cert. denied*, 454 U.S. 1146, 102 S.Ct. 1009, 71 L.Ed.2d 299 (1982).

In FAA § 40102, a "conveyance" is "an instrument, including a conditional sales contract, affecting title to, or an interest in, property." 49 U.S.C. § 40102(19). The FAA defines a conditional sales contract as:

> (A) for the sale of an aircraft, aircraft engine, propeller, appliance, or spare part, under which the buyer takes possession of the property but title to the property vests in the buyer at a later time on –
>
> (i) paying any part of the purchase price;
>
> (ii) performing another condition; or
>
> (iii) the happening of a contingency; or
>
> (B) to bail or lease an aircraft, aircraft engine, propeller, appliance, or spare part, under which the bailee or lessee –
>
> (i) agrees to pay an amount substantially equal to the value of the property; and
>
> (ii) is to become, or has the option of becoming, the owner of the property on complying with the contract.

49 U.S.C. § 40102(18).

Alternatively, under Illinois state law, to determine whether an agreement that purports to be a lease is a true lease or a security agreement, the Court must look to the Illinois Commercial Code, § 1-201(37), which provides in relevant part:

> "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. . . . Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a

transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee; and

> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods;
>
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;
>
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement; or
>
> (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

810 ILCS 5/1-201(37). Section 1-207(37) also sets forth criterion which, found alone, would not be sufficient proof of a security agreement:

> A transaction does not create a security interest merely because it provides that:
>
> > (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;
> >
> > (b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance,

> filing, recording, or registration fees, or service or maintenance costs with respect to the goods;
>
> (c) the lessee has an option to renew the lease or to become the owner of the goods;
>
> (d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or
>
> (e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

Id.

Under the Illinois statutory scheme, in determining whether an agreement that purports to be a lease is actually a security agreement, courts focus on three factors:

> (1) whether the "lessee" is required to make aggregate rental payments to the "lessor" equaling the cost of the leased property plus interest; (2) whether the option price to purchase the leased equipment at the end of the "lease" is nominal; and (3) whether the lease term covers the total useful life of the equipment.

Direct Air, Inc. v. Fairchild Aircraft, Inc. (In re Direct Air, Inc.), 189 B.R. 444, 452 (Bankr.N.D.Ill.1995) (citing *In re Hardy*, 146 B.R. 206, 209 (Bankr.N.D.Ill.1992)). "Substance rules over form and courts will look through a transfer absolute in form to find a secured transaction if that was

the real intent of the parties." *Turk v. Wright & Babcock, Ltd.*, 174 Ill.App.3d 139, 142, 124 Ill.Dec. 102, 103, 528 N.E.2d 993, 994 (3d Dist.1988), *appeal denied*, 124 Ill.2d 562, 129 Ill.Dec. 156, 535 N.E.2d 921 (1989); *see also Meeker v. Beeson*, 76 Ill.App.3d 940, 943, 32 Ill.Dec. 468, 470, 395 N.E.2d 698, 700 (5th Dist.1979) ("in determining the character of an alleged lease of personal property the courts will disregard the mere form and the words and will endeavor to reach the substance of the agreement"). There is a rebuttable presumption that what is labeled or denominated a lease is in fact a bona fide lease absent compelling factors to the contrary. *Liona Corp., N.V. v. PCH Assocs. (In re PCH Assocs.)*, 804 F.2d 193, 200 (2d Cir.1986). Thus, the burden of proving whether or not the lease is bona fide rests with IDOR.

The Court disagrees with IDOR's characterization of the Aircraft Lease/Purchase Agreement as a conditional sale and finds that IDOR has failed to meet its burden of proof on this issue. After close examination of the three factors set forth in *Direct Air*, the Court finds that the Aircraft Lease/Purchase Agreement was in fact a true lease. While the inclusion of an option to purchase in a lease does not in and of itself make the lease one intended for security, where the lessee can become the owner of the leased goods for only nominal consideration at the expiration of the lease, the transaction is in substance a conditional sale. *Orix Credit Alliance, Inc. v. Pappas*, 946 F.2d 1258, 1261 (7th Cir.1991). The option price was not nominal and there is no showing that the lease term covered the useful life of the Aircraft. The fact that Chandler needed additional funds of $10 million to exercise the buy out option when the Aircraft was

appraised at approximately $12.5-12.7 million does not demonstrate that the agreement was in the nature of a disguised sale. The $10 million dollar amount is not nominal nor is it substantially less than the fair market value of the Aircraft in a used condition in September 1988 when the option to purchase was exercised, three months after the Aircraft was leased by Chandler from Prewitt Leasing.

8. *IDOR Failed To Sustain Its Ultimate Burden of Proof*

As already noted above, the District Court held that the NPL was prima facie proof as to all elements of responsible officer liability, including willfulness. *See Stoecker*, 179 B.R. at 544. The burden then shifted to the Trustee to rebut the presumption created by a valid NPL. The presumption was rebutted by the Trustee showing that the Debtor was not in control and thus could not have voluntarily or willfully failed to pay the tax. Alternatively, the Trustee showed that even if the Debtor was in control, he reasonably relied on the legal opinion of Anderson through his agent, Pluhar. The ultimate burden of proof then shifted back to IDOR to show that the nonpayment was willful and to show that IDOR's amended claim should be allowed over the Trustee's objection. *See In re Chapman*, 132 B.R. 132, 143 (Bankr.N.D.Ill.1991) ("Once the objector has produced some evidence disputing the validity of the claim, the burden shifts to the claimant."). Based upon the above evidence, the Court holds that the Trustee has offered substantial evidence to rebut the presumption of willfulness that attached to the NPL and that IDOR has failed to

refute this evidence and to ultimately sustain its burden of proof by a preponderance of the evidence that the Debtor's failure to pay the penalty for Chandler's failure to remit the alleged use tax was willful.

D. *Should the Court Equitably Subordination IDOR's Claim?*[35]

1. *The Trustee's Request for Equitable Subordination is Properly Before the Court*

Initially, the Court will address IDOR's argument that the Trustee's request for equitable subordination is not properly before the Court because the Trustee failed to file an adversary proceeding or a motion for such relief. At the initial status hearing after the remand by the District Court, IDOR agreed to waive the filing of an adversary proceeding by the Trustee provided that he file a motion seeking equitable subordination. The Trustee did not file a motion seeking equitable subordination at that time. On August 22, 1995, the parties filed a Joint Statement on Contested Matters. IDOR again took the position that the Trustee had waived the right to bring an action for equitable subordination unless a motion was promptly filed. *See* Joint Statement on Contested Matters

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[35] Because the Court found that Chandler did not owe the tax and that even if Chandler owed the tax, the Debtor did not willfully fail to pay it, the Court need not address the issue of equitable subordination. However, in the interest of completing the record, and because the issue was directly raised and remanded by the District Court in its opinion for possible determination, the Court will discuss the issue. *See Stoecker*, 179 B.R. at 539, 544.

at 8. On March 21, 1996, the Trustee presented the instant motion for summary judgment in which he seeks entry of a judgment against IDOR equitably subordinating its claim. The Trustee has not filed a separate motion seeking equitable subordination. Consequently, IDOR contends that the issue of equitable subordination of its claim is not properly before the Court.

Procedurally, the Court notes that to the extent the Trustee has alleged that IDOR's claim should be equitably subordinated, he must normally file an adversary proceeding. *See* Fed.R.Bankr.P. 7001(8). However, a party may waive its right to object to the other party's failure to file an adversary proceeding. *See In re Pence*, 905 F.2d 1107, 1109 (7th Cir.1990). IDOR agreed to waive the formal requirement of filing an adversary proceeding provided the Trustee file a motion seeking such relief. The Trustee subsequently filed the instant motion for summary judgment, in which, among other things, he requested that IDOR's claim be subordinated. IDOR has, therefore, waived its right to object.

The Court finds that this motion is sufficient to raise the issue of equitable subordination of IDOR's claim before the Court. Moreover, the District Court's remand requires the Court to consider the issue of whether or not IDOR's claim should be equitably subordinated.[36] Thus,

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[36] Specifically, the District Court stated that "[w]e remand this case to the bankruptcy court to consider whether [IDOR's] late filed claim should be subordinated under the principles of equitable subordination." *See Stoecker*, 179 B.R. at 539. Further, the District Court noted in its Supplemental Memorandum Opinion "[i]f the Bankruptcy Court allows the claim, then it

although the Court agrees that equitable subordination is technically not properly before this Court because the Trustee failed to file an adversary proceeding pursuant to Bankruptcy Rule 7001(8), the Court finds that IDOR has effectively waived such procedural formality and the Court may hear the issue.

2. *Applicable Statute and Case Law Regarding Equitable Subordination*

The doctrine of equitable subordination recognizes the bankruptcy court's fundamental role as a court of equity, and permits the court to disallow or subordinate claims which, if recognized, would produce unjust results. *Pepper v. Litton*, 308 U.S. 295, 304-06, 60 S.Ct. 238, 244-45, 84 L.Ed. 281 (1939); *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1248 (7th Cir.1990); *De'Medici v. Salson Express Co. (In re Lifschultz Fast Freight)*, 191 B.R. 712, 714 (N.D.Ill.1996). The doctrine is codified at 11 U.S.C. § 510(c), which provides in relevant part:

> (c) Notwithstanding subsections (a) and (b) of this section, after notice and hearing, the court may –
>
> > (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest. . . .

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must determine whether the claim should be equitably subordinated in accordance with this court's August 30, 1994 Memorandum Opinion and Order." *Id.* at 544.

11 U.S.C. § 510(c). The Seventh Circuit set forth three elements that a court should consider in deciding whether to equitably subordinate a claim: (1) whether the creditor engaged in misconduct; (2) whether that misconduct resulted in injury to other creditors or an unfair advantage to the miscreant; and (3) whether subordination of the debt would be inconsistent with other provisions of the Bankruptcy Code. *In re Vitreous Steel Prods. Co.*, 911 F.2d 1223, 1237 (7th Cir.1990).

Recently, the United States Supreme Court rendered its decision in *United States v. Noland*, ___ U.S. ___, 116 S.Ct. 1524, 134 L.Ed.2d 748 (1996). In *Noland*, the Supreme Court held that bankruptcy courts do not have the power to categorically subordinate the government's claim for a post-petition noncompensatory tax penalty, which is entitled under the Bankruptcy Code to priority distribution, in derogation of Congress's scheme of priorities, in the absence of inequitable conduct by the government. *Id.* at ___, 116 S.Ct. at 1528. Specifically, the Court found the categorical reordering of priorities that takes place at the legislative level of consideration is beyond the scope of judicial authority to order equitable subordination under § 510(c). *Id.* at ___, 116 S.Ct. at 1528 ("Congress could have, but did not deny noncompensatory, postpetition tax penalties the first priority given to other administrative expenses, and bankruptcy courts may not take it upon themselves to make that categorical determination under the guise of equitable subordination."). *See United States v. Reorganized CF & I Fabricators of Utah, Inc.*, ___ U.S. ___, 116 S.Ct. 2106, 135 L.Ed.2d 506 (1996) (discusses *Noland*).

The *Noland* case expressly declined to decide "whether a bankruptcy court must always find creditor misconduct before a claim may be equitably subordinated." ___ U.S. at ___, 116 S.Ct. at 1528. Nevertheless, the Seventh Circuit has repeatedly held that misconduct is not necessarily required to subordinate a claim. *Virtual Network*, 902 F.2d at 1250 ("§ 510(c)(1) authorizes courts to equitably subordinate claims to other claims . . . without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors."); *see also In re Envirodyne Indus., Inc.*, 79 F.3d 579, 581 (7th Cir.1996) (citing *Virtual Network*), *cert. denied*, ___ U.S. ___, 117 S.Ct. 77, 136 L.Ed.2d 36 (1996). The inquiry to be made is on a case by case basis, while focusing on the fairness to all creditors involved. *See Vitreous Steel*, 911 F.2d at 1237; *Schwab v. Aetna Bank (McDonald Creek Development Co.)*, 1996 WL 139396 (N.D.Ill. March 20, 1996) (citing *Virtual Network*).

IDOR contends that *Noland* effectively overrules *Virtual Network* and *Envirodyne*. The Court rejects IDOR's view that these cases are overruled by the *Noland* decision. *Noland* explicitly declined to address the issue of whether misconduct by the creditor was required to subordinate a claim. ___ U.S. at ___, 116 S.Ct. at 1528. The *Noland* case instead stands for the proposition that a bankruptcy court cannot categorically subordinate claims to reorder the legislative policy embodied in the various provisions established under the Bankruptcy Code.

3. *The Evidence Does Not Mandate Equitable Subordination of IDOR's Claim*

The Trustee maintains that IDOR's claim should be equitably subordinated because it violated the automatic stay on the three instances discussed above. The Trustee concludes that the facts in this case, including IDOR's alleged repeated violations of the automatic stay, coupled with its dilatory conduct in filing its claim, merit equitable subordination.

IDOR contends that its claim should not be equitably subordinated because it did not violate the automatic stay. As the Court previously discussed, the actions taken by IDOR against the Debtor were not in violation of the automatic stay. Consequently, the Trustee's argument for equitable subordination on this basis lacks merit and is rejected. The Court is further obliged to follow the law of the case, as found by the District Court, that the tardiness in the filing of IDOR's claim at bar is not ipso facto grounds for its disallowance. *See Stoecker*, 179 B.R. at 538-39.

Based upon the evidence presented and the above cited case law, the Court finds that IDOR's claim should not be equitable subordinated pursuant to § 510(c). IDOR has admitted it had knowledge of the Debtor's bankruptcy case shortly after it was filed in February 1989; IDOR timely filed other claims in the case; and IDOR, including the audit and collection employees who were investigating the Aircraft purchase, knew that the Debtor was the president and a potential responsible officer of Chandler before the June 26, 1990 claims bar date. *See Stoecker*, 151 B.R. at 997. IDOR, with such knowledge of

the Debtor's bankruptcy case, did not file its proof of claim for the taxes at issue until January 21, 1992, one-and one-half years after the claims bar date. It was not until February 1990, one and one-half years after the sale of the Aircraft, but within the time fixed by the Court for filing proofs of claim, an IDOR revenue auditor began investigating the sale from Prewitt Leasing to Chandler. (Tr. (Russell) 52).

The mere fact that IDOR failed to exercise due diligence in filing its claim does not, in and of itself, serve as a proper basis for equitable subordination in light of the District Court's decision. Whether IDOR filed its claim one day after the bar date or one and one-half years after the bar date, the result is the same – the claim was tardy.

The Court finds that the failure of IDOR's auditor, field collector, and employees of the NPL unit to discover the connection between the liability assessed against Chandler and the penalty assessed against the Debtor was caused principally by Chandler's failure to register the Aircraft with the Illinois Department of Transportation's Division of Aeronautics in 1988 as required by Ill.Rev.Stat., ch. 15 1/2 , ¶ 22.42 (1989). Pursuant thereto, Chandler would have been required to show that the use tax was paid or that the purchase was exempt upon registering the Aircraft as leased in Illinois. The evidence supports a finding that IDOR's failure to timely file the instant claim by the bar date was not intentional or deliberate. Consequently, the Trustee's request for equitable subordination is hereby denied.

V. CONCLUSION

For the foregoing reasons, the Court hereby partially grants the Trustee's motion for summary judgment. The Court holds that Chandler did not owe a use tax. The Court further holds that even if Chandler owed the use tax, IDOR has failed to prove that the Debtor willfully failed to pay it. The Trustee's objection to IDOR's claim is, in part, sustained and the claim is disallowed. However, if IDOR held a valid claim against the Debtor, the Court would not equitably subordinate IDOR's claim under 11 U.S.C. § 510(c) in the circumstances of this case.

This Opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate order shall be entered pursuant to Federal Rule of Bankruptcy Procedure 9021.

ORDER

For the reasons set forth in a Memorandum Opinion dated October 17, 1996, the Court hereby partially grants the motion of Thomas E. Raleigh, the Chapter 7 trustee, for summary judgment. The objection of Thomas E. Raleigh to the Illinois Department of Revenue's claim is sustained in part and the claim is disallowed. The Court holds that Chandler Enterprises, Inc. did not owe a use tax assessed against it by the Illinois Department of Revenue. Even if Chandler owed the use tax, the Court further holds that the Illinois Department of Revenue has failed to prove that the Debtor, William J. Stoecker, willfully failed to pay the tax. Finally, if the Illinois Department of

Revenue held a valid claim against the Debtor, the Court would not equitably subordinate the claim under 11 U.S.C. § 510(c).

APPENDIX D

In re William J. STOECKER, Debtor.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE, Appellant,

v.

Thomas E. RALEIGH as Trustee of the Estate of William J. Stoecker, Appellee.

Nos. 93 C 2160, 89 B 2873.

United States District Court, N.D. Illinois, Eastern Division.

Aug. 31, 1994.

Opinion Granting Rehearing and Denying Certification for Appeal March 23, 1995.

James Douglas Newbold, Illinois Atty. General's Office, Chicago, IL, for Etolen and Buchanan Masonry, State of Ill., Dept. of Revenue.

Robert Radasevich, David A. Eide, George Michael Hoffman, Neal, Gerber & Eisenberg, Chicago, IL, for Thomas E. Raleigh.

Thomas E. Raleigh, Raleigh and Helms, Chicago, IL, for William J. Stoecker.

MEMORANDUM OPINION AND ORDER

ANDERSEN, District Judge.

This case is before the court on the appeal of the State of Illinois Department of Revenue ("Department") from the United States Bankruptcy Court for the Northern District of Illinois. *In re Stoecker,* 151 B.R. 989

(Bankr.N.D.Ill.1993) (Squires, J., presiding). The principal issue in this case is whether Rule 3002 of the Federal Rules of Bankruptcy Procedure ("Rule ___") acts as a bar date to exclude late filed priority claims in a Chapter 7 case. The court holds that Rule 3002 does not bar late filed priority claims. In addition, the court concludes that principles of equitable subordination should determine whether late filed priority claims are entitled to distribution, and if so, the particular distribution level they are entitled to under 11 U.S.C. § 726. For the following reasons, the bankruptcy court's decision is reversed and remanded for further proceedings in accordance with this opinion.

BACKGROUND

This case began as an involuntary Chapter 11 petition against William J. Stoecker ("Debtor") and was converted to Chapter 7 on February 26, 1990. Thomas E. Raleigh ("Trustee") was appointed the Chapter 11 trustee of the Debtor's estate and was reappointed as the Chapter 7 trustee. Pursuant to 11 U.S.C. § 341(a), a meeting of creditors was held on March 28, 1990. As required by Rule 3002(c), all proofs of claim were to be filed on or before June 26, 1990 ("the bar date"), ninety days after the meeting. On July 25, 1989, the Department timely filed three proofs of claim totalling $14,852.03.

Prior to the above proceedings, the Debtor had purchased an aircraft from Prewitt Leasing, Inc. ("Prewitt") on September 30, 1988. At that time, he was president and sole director of Chandler Enterprises, Inc. ("Chandler").

Chandler subsequently leased the aircraft to Grabill Corporation ("Grabill"), a corporation in which the Debtor was president and sole shareholder. Neither Chandler nor Prewitt paid any sales/use tax, withholding tax, or income tax on Chandler's purchase of the aircraft. The Debtor states that his attorney advised him that there was no sale or use tax properly assessable or payable as a result of the purchase by Chandler or the lease of the aircraft by Chandler to Grabill. Chandler was involuntarily dissolved by the Illinois Secretary of State on June 1, 1990.

After the Department received notice of the Debtor's bankruptcy filing, the Department researched his liability to the Department. Apparently due to Chandler's failure to register with the Department and to file any tax returns, the Department did not determine that the Debtor was an officer of Chandler during this initial search. Nevertheless, in approximately February, 1990, the Department conducted a separate investigation into the records of the Federal Aviation Administration. At that time, the Department learned of Chandler's purchase of the aircraft. The Department wrote two letters to Chandler dated March 7, 1990 and June 7, 1990 seeking additional information in order to ascertain whether the purchase of the airplane was subject to use tax. Chandler did not respond to either letter.

On September 7, 1990, the Department issued a Notice of Penalty Liability against Chandler. Between September 26, 1991 and April 9, 1991, the Department attempted to contact Chandler and its officers but was unsuccessful. Subsequently, a Notice of Penalty Liability was issued against the Debtor on August 15, 1991. The

Department sent the Debtor a demand for full payment of the tax liability claimed on September 25, 1991. On January 21, 1992, approximately 18 months after the bar date, the Department filed a proof of claim in the amount of $1,476,196.86 for Retailers' Occupation/Use Tax allegedly owed by the Debtor as the responsible officer of Chandler.

The Trustee objected to the January 21, 1992 proof of claim filing because it was filed after the bar date fixed by Rule 3002(c). In addition, the Trustee also argued that the Debtor is not liable for the use tax under the "occasional sale" exemption.

In the bankruptcy court, the Department argued that the court should allow the claim as an amendment to the earlier filed proofs of claim pursuant to Fed.R.Civ.P. 15. In the alternative, the Department asked the bankruptcy court to use its equitable powers to allow the claim.

In its Memorandum, Opinion, and Order dated November 25, 1992, the bankruptcy court sustained the Trustee's objection and did not allow the Department's claim. It found that the Department's proof of claim was tardily filed. The court reasoned that the claim was an entirely new claim, and not an amendment to an earlier filed claim. Accordingly, the amendment was barred by Rule 3002(c). Furthermore, the court declined to allow the claim under its equitable powers.

The Department filed a motion for reconsideration of the bankruptcy court's decision to sustain the Trustee's objection on December 10, 1992. The motion was based in part on the *In re Rago*, 149 B.R. 882 (Bankr.N.D.Ill.1992)

case, which was decided two days prior the court's original ruling, and reached a contrary result. The court denied the motion for reconsideration on February 23, 1993.

The Department now appeals the bankruptcy court's decision. This action was a core proceeding before the bankruptcy court under 28 U.S.C. § 157(b)(2)(B). This court has jurisdiction pursuant to 28 U.S.C. § 158(a).

DISCUSSION

Rule 8013 provides that a district court must accept the bankruptcy court's findings of fact unless clearly erroneous. Fed.R.Bankr.P. 8013; *In re Tolona Pizza Prod. Corp.*, 3 F.3d 1029, 1033 (7th Cir.1993). However, the court may independently examine the bankruptcy court's conclusions of law. *In re Yonikus*, 996 F.2d 866, 868 (7th Cir.1993). Accordingly, this court subjects the bankruptcy court's conclusions of law to *de novo* review. *In re UNR Indus., Inc.*, 986 F.2d 207, 208 (7th Cir.1993).

I. *Preliminary Issue*

The court must first determine whether the Department improperly raised new matters before the bankruptcy court in its motion for reconsideration. The Trustee contends that the Department improperly used its motion to argue for the first time that untimeliness can never constitute a proper basis for disallowance of a proof of claim. This theory was espoused by Bankruptcy Judge Wedoff in *In re Rago*.

The Trustee cites *Publishers Resource, Inc. v. Walker-Davis Publications, Inc.*, 762 F.2d 557 (7th Cir.1985), to support the proposition that motions to reconsider serve "to correct manifest errors of law or fact or to present newly discovered evidence." *Publishers Resource*, 762 F.2d at 561 (citing *Keene Corp. v. Int'l Fidelity Ins. Co.*, 561 F.Supp. 656, 665-66 (N.D.Ill.1982), *aff'd*, 736 F.2d 388 (7th Cir.1984)). Moreover, such motions should not "serve as the occasion to tender new legal theories for the first time." *Id.* The Trustee also cites *Havoco of America, Ltd. v. Sumitomo Corp. of America*, 971 F.2d 1332, 1336 (7th Cir.1992) for the broad proposition that a legal argument raised for the first time on a motion for reconsideration is waived if not presented before judgment was entered.

In response, the Department argues that *In re Rago* represents a significant development in the law pertaining to the area of allowances. Furthermore, the Department subsequently brought to our attention *In re Vecchio*, 20 F.3d 555 (2nd Cir.1994) which adopted the rationale of *In re Rago* and was decided after the court denied the motion for reconsideration. The bankruptcy court in the case at hand relied heavily on *United States v. Vecchio*, 147 B.R. 303 (E.D.N.Y.1992), the decision that *In re Vecchio* explicitly reversed. *In re Vecchio* at 556. It is also significant to note that the author, Judge Wedoff, of *In re Chirillo*, 84 B.R. 120 (Bankr.N.D.Ill.1988), a case cited with approval by the bankruptcy court in this case, later rejected *Chirillo* by stating that the case was based on the mistaken assumption that a late filed claim is disallowed. *In re Rago*, 149 B.R. at 885.

In light of these developments, this court holds that the Department's new argument is properly before the

court on appeal. Both *In re Rago* and *In re Vecchio* represent highly persuasive authority that the Department could not have presented to the bankruptcy court before it delivered its opinion.

Furthermore, the court does not read the *Havoco* decision as broadly as the Trustee. In that case, the court simply held that a Fed.R.Civ.P. 59(e) motion to alter or amend the judgment "cannot be used to raise new arguments which could and should have been raised before judgment was entered." *Havoco*, 971 F.2d 1332 at 1336. The Trustee correctly points out that, before the bankruptcy court entered judgment in this case, limited authority was available to the Department to support the theory it now advances. However, this court can not conclude that a reasonable litigant in the Department's position should have raised the new argument prior to the bankruptcy court's decision, particularly when it could not have known about *In re Rago* or *In re Vecchio*.

Therefore, the court holds that the Department's new argument is properly before the court on appeal.

II. *Interrelation of Rule 3002 and 11 U.S.C. §§ 501, 502 and 726*

The principal issue in this case is whether Rule 3002 acts as a bar date to exclude late filed priority claims in a Chapter 7 proceeding. That rule provides in pertinent part:

> (a) NECESSITY FOR FILING. An unsecured creditor or an equity security holder must file a proof of claim or interest in accordance with this rule for the claim or interest to be allowed. . . .

> (c) TIME FOR FILING. In a chapter 7 liquidation . . . a proof of claim shall be filed within 90 days after the first date set for the meeting of creditors called pursuant to § 341(a) of the Code. . . .

Fed.R.Bank.P. 3002. There are also several code provisions dealing with the filing and allowance of proofs of claim, and distribution of property of the estate. Section 501(a) states that "[a] creditor . . . may file a proof of claim." 11 U.S.C. § 501(a). Section 502(a) then explains that, "[a] claim . . . , proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects." 11 U.S.C. § 502(a). Section 502(b) lists eight categories upon which a party in interest can base its objection. Of particular significance is the provision allowing a party to object if the claim is unenforceable under "applicable law." 11 U.S.C. § 502(b)(1).

Finally, § 726 describes the distribution of property of the estate:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed –
>
> (1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title;
>
> (2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is –
>
> (A) timely filed under section 501(a) of this title;
>
> (B) timely filed under section 501(b) or 501(c) of this title; or

> (C) tardily filed under section 501(a) of this title, if –
>
> (i) the creditor that holds such a claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and
>
> (ii) proof of such claim is filed in time to permit payment of such claim;
>
> (3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title other than a claim of the kind specified in paragraph (2)(C) of this subsection;
>
> (4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim;
>
> (5) fifth, in payment of interest at the legal rate form the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection; and
>
> (6) sixth, to the debtor.

11 U.S.C. § 726.

The Department argues that because these code sections are in conflict with Rule 3002, the code provisions should prevail. *U.S. v. Cardinal Mine Supply, Inc.*, 916 F.2d

1087, 1089-90 (6th Cir.1990). According to the Department, a conflict exists because Rule 3002 makes it clear that for a proof of claim to be allowed it must be filed within 90 days after the date set for the meeting of creditors. In contrast, § 501 contains no prohibition on the filing of claims after the bar date and § 502 states that a claim is allowed assuming the absence of a valid objection. None of the categories listed in § 502(b) upon which a party can base an objection explicitly includes the late filing of a claim. The Department emphasizes that §§ 726(a)(2)(C) and 726(a)(3) explicitly provide for "allowed claims, proof of which is *tardily* filed." (emphasis added). This approach was advanced by the recent *In re Rago* case.

The bankruptcy court rejected this argument and did not find that Rule 3002 was in conflict with the code. *In re Stoecker*, 151 B.R. at 995. The court stated that § 502(b)(1) provides for disallowance of a claim that is unenforceable under applicable law and that Rule 3002(c) constitutes applicable law. *Id.* Therefore, the court concluded that § 502(b)(1) disallows a claim not filed pursuant to Rule 3002(c) when a party in interest raises an objection to the claim. *Id.*

According to the Department, this rationale is flawed because there is still a conflict between Rule 3002 and § 726(a). In its opinion denying the motion for reconsideration, the bankruptcy court addressed this problem. It noted that, during those infrequent situations when there are sufficient funds available to fully pay all claims that were both timely and tardily filed, the trustee would not need to file an objection to late filed claims. The court stated that in these cases there is no need for a trustee to

object to late filed claims because there are enough funds to pay all claims.

In response, the Department argues that the bankruptcy court's reasoning is flawed for three reasons. First, it assumes that a claim which is untimely filed under Rule 3002 is allowed under § 502(a) unless the trustee objects to it. However, Rule 3002 explicitly states that a claim not filed in conformity with it is not allowed. Second, the court's position also assumes that a late filed claim is only disallowed if the trustee files an objection. If the trustee does not object, the claim is allowed. Third, the court's conclusion is subject to abuse because § 502(a) allows any party in interest to object. Thus, a creditor with a timely but subordinated claim would always object to a late filed claim to increase its distribution. A debtor who is entitled to all funds left over after payment of allowed claims would also object to late claims for the same reason.

The Department urges the court to reject the position taken by courts in cases exemplified by *In re Zimmerman*, 156 B.R. 192 (Bankr.W.D.Mich.1993) (en banc). *In re Zimmerman* was a Chapter 13 case and described two types of allowance of claims: 1) procedural allowance under § 501 which looks to Rule 3002 to establish time limits and 2) substantive allowance pursuant to § 502 where a claim is considered on the merits. *Id.* at 198. According to this analysis, a claim is deemed filed under § 501(a) only if it is filed within the time limits set by Rule 3002. *Id.* If the claim is filed late it is not allowed, and § 502 never comes into play. *Id.; see also In re Johnson*, 156 B.R. 557 (Bankr.N.D.Ill.1993). The Trustee attempts to extend this rationale to resolve the conflict between Rule 3002 and

§§ 726(a)(2)(C) and 726(a)(3). It asserts that the § 726 provisions provide only for distribution of claims allowed on the merits under § 502.

Not surprisingly, the Trustee relies heavily on *In re Zimmerman* to support his position that tardiness is a ground for disallowance of a claim under § 502. That case recognized that § 501(c) contemplates a timeliness requirement: "If a creditor does not *timely* file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim." (emphasis added). *In re Zimmerman*, 156 B.R. at 195-96. It also noted that legislative history indicates that Congress intended for the Bankruptcy Rules to contain the procedural aspects of bankruptcy practice. *Id.* at 197.

The Trustee next tries to explain why the "tardily filed" language exists in §§ 726(a)(2)(C) and 726(a)(3). It states that it is appropriate for the provisions to contain this language to distinguish substantively meritorious claims from substantively infirm ones. Further, it contends that *In re Rago* does not apply here because that case involved a late filed original claim, whereas the Department has maintained throughout that its claim is an amendment of a previously filed timely claim. *See In re Unroe*, 937 F.2d 346 (7th Cir.1991).

This court holds that Rule 3002 does not act as a bar date to exclude late filed priority claims in a Chapter 7 case. The decision in *In re Vecchio*, 20 F.3d 555 (2nd Cir.1994) is particularly persuasive. It stated that, "to the extent Rule 3002 suggests that a late filed claim must be disallowed, it is inconsistent with the text of §§ 726, 502, and 501." *In re Vecchio*, at 559; *Cardinal Mine*, 916 F.2d at

1089. The court observed that § 501 does not impose a timeliness requirement. *In re Vecchio*, at 559. Similarly, not only is there no requirement in § 726(a) that allowance of a claim requires a timely filing, but §§ 726(a)(2)(C) and 726(a)(3) expressly order the payment of such claims. *Id.* at 558. Furthermore, untimeliness is not listed as a grounds for disallowance under § 502. *Id.* at 558-59. This court rejects the Trustee's notion that the "tardily filed" language was inserted in these provisions to remove substantively infirm claims from distribution. There is no logical reason for Congress to provide an entire list of grounds for disallowance in one provision entitled "Allowance of claims or interests," while inserting another ground for disallowance in a separate provision entitled "Distribution of property of the estate."

Accordingly, this court can only conclude that *In re Hausladen*, 146 B.R. 557, 559 (Bankr.D.Minn.1992) was correct when it stated that Rule 3002's erroneous implication that filing within the prescribed period is a prerequisite to allowance "arose when the drafters of the new Rule 3002 hastefully copied the substance of *old* Rule 302 without paying any attention to the major change in the underlying statute." (emphasis in original). *See also In re Rago*, 149 B.R. at 885. Section 726 does not bar tardily filed claims. *In re Vecchio*, at 559 (citing *Cardinal Mine*, 916 F.2d at 1091).

Since *In re Zimmerman* is a Chapter 13 case, the court will not apply it here. Unlike Chapter 13 cases where payments are distributed under a plan, § 726 provides for the order of distribution of property of the estate in Chapter 7 cases. Even if *In re Zimmerman* resolves the conflict between Rule 3002 and §§ 501 and 502, it simply

can not resolve the conflict between Rule 3002 and §§ 726(a)(2)(C) and 726(a)(3). Therefore, the court will not apply the reasoning of *In re Zimmerman* to this Chapter 7 case.

Moreover, the court in *In re Vecchio* saw no relevance to the fact that the Internal Revenue Service in that case filed amended claims of a previously filed timely claim, as opposed to a late filed original claim. Since the facts in this case are similar, the court does not believe it is necessary to decide whether the Department filed an amended or original claim. Additionally, the court agrees with the Department that the other cases the Trustee cites in support of its argument, i.e., *Wilkens v. Simon Brothers, Inc.*, 731 F.2d 462 (7th Cir.1984), *In re Danielson*, 981 F.2d 296 (7th Cir.1992), and *Holstein v. Brill*, 987 F.2d 1268 (7th Cir.1993) do not address the specific issue in this case.

We disagree with the decisions in other jurisdictions which have subordinated first-tier priority claims to the third-tier of distribution as non-priority claims based on the tardiness of their filing. *See IRS v. Ulrich (In re Mantz)*, 151 B.R. 928, 930-31 (9th Cir. BAP 1993); *In re Elec. Management, Inc.*, 133 B.R. 90, 92 (Bankr.N.D.Ohio 1991); *In re Mayville Feed & Grain, Inc.*, 123 B.R. 245, 246-47 (Bankr.E.D.Mich.1991). As stated in *In re Vecchio*:

> These courts have also read a timeliness requirement into § 726(a)(1) despite the absence of such language in that provision or in others in the Code, and have failed to address the inconsistencies that arise as a result of their narrow reading of § 726(a)(1) to exclude late filed priority claims, their broad reading of § 726(a)(3) to include late filed priority claims, and their construction of Rule 3002 to permit subordination and not disallowance of such claims.

20 F.3d at 559.

Nevertheless, the court differs with the Department's contention that priority claims, regardless of when they are filed, are automatically entitled to receive a first level distribution pursuant to § 726(a)(1). The court agrees with *In re Rago* that such a rule would not encourage finality in the administration of claims. *In re Rago*, 149 B.R. at 888 (citing *In re Evanston Motor Co.*, 26 B.R. 998, 1005 (N.D.Ill.1983)). This concern is particularly valid when claimants deliberately or negligently fail to file their claims within the time limit established by the Bankruptcy Rules. *Id.*

Therefore, the court concludes that bankruptcy courts should use principles of equitable subordination when dealing with late filed priority claims. *Id.* at 889-90; *In re Vecchio*, at 560; *see also In re Virtual Network Serv. Corp.*, 902 F.2d 1246 (7th Cir. 1990). As discussed in *In re Rago*, 149 B.R. at 889-90, § 726(a) provides that property of the estate shall be distributed "[e]xcept as provided in section 510 of this title." Section 510(c)(1) provides that "after notice and a hearing, the court may . . . under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim." As stated in *In re Rago*:

> Where, despite adequate notice or knowledge of the bankruptcy, a priority creditor fails to file a timely proof of claim, it may be equitable to subordinate the creditor's claim to claims that

> were timely filed. Since general considerations of fairness will support subordination even without inequitable conduct on the part of the creditor, an unexcused delay by the creditor in filing a proof claim certainly provides a basis to subordinate. Moreover, based on general considerations of fairness, it may be equitable to subordinate a late filed priority claim even where the creditor lacked adequate notice or knowledge, if a distribution has already taken place and an undoing of the distribution would be excessively burdensome. In either situation, the notice and hearing provision of Section 510(c) will assure that the priority creditor can present the arguments against subordination to the court.

Id. at 890.

The court believes that the reasoning in *In re Rago* fairly and appropriately balances the interests of all parties in these types of cases. Particularly when a priority claim is filed after disbursement of an estate, courts should carefully weigh the benefits and burdens of all parties to reach a just and equitable result. *In re Vecchio*, at 560.

CONCLUSION

For the forgoing reasons, the decision of the bankruptcy court ruling that § 11 U.S.C. 502(b)(1) disallows a claim not filed pursuant to Rule 3002(c) is reversed. We remand this case to the bankruptcy court to consider whether the Department's late filed claim should be subordinated under the principles of equitable subordination.

SUPPLEMENTAL MEMORANDUM, OPINION AND ORDER

Thomas E. Raleigh, Chapter 7 Bankruptcy Trustee (the "Trustee") in the Estate of William J. Stoecker (the "Debtor") has moved for a rehearing of this Court's August 30, 1994 Memorandum, Opinion and Order (the "Opinion") pursuant to Fed.R.Bank.P. 8015. Additionally, the Trustee moves this court for certification for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). In the Opinion, this court reversed the Bankruptcy Court's decision which had disallowed a priority tax claim asserted by the State of Illinois Department of Revenue (the "Department") against the Debtor because the proof of claim was untimely filed. The Opinion remanded the case to the Bankruptcy Court to determine whether the Department's tardily filed claim should be equitably subordinated.

In its current motion, the Trustee correctly points out that the Opinion failed to address the second issue presented in the appeal, namely, the Bankruptcy Court's substantive disallowance of the claim on the merits. Specifically, the Bankruptcy Court disallowed the claim because the Department had failed to establish that the Debtor, as a responsible officer of the non-debtor corporation, Chandler Enterprises, Inc. ("Chandler"), had wilfully failed to pay the use tax assessed against Chandler.

For the following reasons, this court grants the motion for rehearing to review whether the claim should have been disallowed on the merits, reverses the Bankruptcy Court's decision to disallow the claim, remands

the matter for a new hearing and/or evaluation of the evidence, and denies the motion for certification.

STANDARD OF REVIEW

Federal Rule of Bankruptcy 8015, which governs motions for rehearing, is silent as to the appropriate standards for granting such relief. However, because Fed.R.Bank.P. 8015 was derived from Fed.R.App.P. 40, it is appropriate to look to the appellate rule for guidance. 9 Collier on Bankruptcy 8015.04 at 6015-4 (15th ed. 1993). Federal Rule of Appellate Procedure 40 provides in part, "[t]he petition must state with particularity the points of law of fact which in the opinion of the petitioner the court has overlooked or misapprehended. . . . " Accordingly, this motion for rehearing is properly before this court.

DISCUSSION

When deciding an appeal from a bankruptcy court, a district court must accept the bankruptcy court's findings of fact unless they are clearly erroneous. *In re Evanston Motor Co.*, 735 F.2d 1029, 1031 (7th Cir.1984); *In re Robinson*, 169 B.R. 171, 174 (N.D.Ill.1994). But "where there are pure questions of law or mixed questions of law and fact, the District Court may conduct a de novo review." *In re Mader*, 108 B.R. 643, 644 (N.D.Ill.1989). Because the decision below involved mixed law and fact questions, we conduct de novo review.

The Department's claim against Chandler is based on a use tax assessed under section 3 of the Use Tax Act,

Ill.Rev.Stat., ch. 120, para. 439.3 (codified as 35 ILCS 105/3). Section 12 of the Use Tax Act, Ill.Rev.Stat., ch. 120, par. 439.12 (codified as 35 ILCS 105/12), in turn, incorporates by reference section 13½ of the Retailer's Occupation Tax Act ("ROTA"), Ill.Rev.Stat., ch. 120, par. 452½ (1991) (codified as 35 ILCS 120/13.5 (West 1992)). Section 13½ of the ROTA provides that a responsible individual may be liable for taxes under certain circumstances when a corporate taxpayer fails to pay the taxes to the Department. Accordingly, the Department brought the instant claim against the Debtor because Chandler did not pay the assessed use tax. The Department argued that the Debtor was liable for the amount of the tax based on the Debtor's status as a "responsible officer" who wilfully failed to pay the use tax which had been assessed against Chandler pursuant to the Use Tax Act.

Section 13½ of the ROTA provides, in part, as follows:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed . . . and who wilfully fails to file such return or to make such payment to the Department or wilfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon. . . .

35 ILCS 120/13.5. Thus, the statutory language is unambiguous and clearly states that a person responsible for withholding and paying over taxes who wilfully fails to

do so is liable for a penalty equal to the total amount of the unpaid taxes.

Section 13½ of the ROTA also sets forth the method by which the Department establishes the liability against a person who it believes to be a "responsible officer" of a corporation and the method by which the Department proves the liability at a hearing. Section 13½ further provides:

> The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of such determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or any legal proceeding and shall be prima facie proof of the correctness of the penalty due, as shown thereon. The Department shall in every case issue a notice of penalty liability for the amount claimed by the Department pursuant to this Section. Procedures for protest and review of a notice of penalty liability issued pursuant to this Section and assessment of the penalty due hereunder shall be the same as those prescribed for protest and review of a notice of tax liability and the assessment of tax liability under this Act as set forth in Sections 5 and 12 of this Act [35 ILCS 120/5 and 35 ILCS 120/12].

35 ILCS 120/13.5.

On August 15, 1991, the Department issued its Notice of Penalty Liability ("NPL") against the Debtor for the outstanding use taxes which it had previously assessed against Chandler by issuance of its NPL against Chandler on September 9, 1990. The liability established by the issuance of the NPL was the basis of the claim against the Debtor.

In the bankruptcy proceeding, the Trustee asserted that Chandler was not liable for the use tax on its purchase of the aircraft and, therefore, the Debtor could have no liability as a "responsible officer" of Chandler. The Trustee claimed that Chandler's purchase of the aircraft from Prewitt Leasing was an "occasional sale" exempt from use tax because Prewitt Leasing was not a "retailer." In its reply, the Department took the position that the Bankruptcy Court lacked jurisdiction to decide the tax liability of Chandler as a non-debtor whose liability had already been determined under state law. In addition, the Department denied that the sale was exempt from use tax.

At trial, the Department submitted into evidence, under certificate of the Director of the Department of Revenue, the NPL issued against the Debtor. In support of its position that the purchase of the aircraft was an occasional sale exempt from use tax and that the Debtor had no liability as a responsible officer of Chandler, the Trustee presented the testimony of John Anderson. Mr. Anderson was the attorney who had represented Chandler with respect to the purchase of the aircraft. He testified that he had issued an opinion letter to the financing company concluding that, under Illinois law,

there was no sale or use tax properly assessable or payable as a result of the purchase of the aircraft by Chandler or the lease of the aircraft by Chandler to Grabill. This opinion was supported by the Vice-President of Prewitt Leasing, Inc. who signed a "Certificate Re Occasional Seller Exemption from Illinois Sales and Use Tax" on September 30, 1988. However, he testified that he never issued such an opinion letter to Chandler or any of its officers.

As a preliminary matter, the Bankruptcy Court properly found that it had jurisdiction to determine the tax liability of a non-debtor entity such as Chandler pursuant to the plain language of 11 U.S.C. § 505(a)(1). *In re Stoecker*, 151 B.R. 989, 998-99 (Bankr.N.D.Ill.1992). Pursuant to 11 U.S.C. § 505(a)(1), the court is authorized to "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." 11 U.S.C. § 505(a)(1). In addition, the Bankruptcy Court relied on several decisions which held that a bankruptcy court may apply section 505(a) to determine the tax liability of parties other than the debtor. *In re Stoecker*, 151 B.R. at 998-99 (citing *In re Wolverine Radio Co.*, 930 F.2d 1132 (6th Cir.1991); *In re Goldblatt Bros.*, 106 B.R. 522 (N.D.Ill.1989); *In re Major Dynamics, Inc.*, 14 B.R. 969 (S.D.Cal.1981)). On remand, if the Bankruptcy Court finds that the Debtor wilfully failed to pay the use tax assessed against Chandler, the Court must also make the finding that Chandler owed the assessed tax.

The Bankruptcy Court then found that, as president and sole director of Chandler, the Debtor was in control of Chandler. *Stoecker*, 151 B.R. at 1000. Next, the court found that the Department had established a prima facie case by introducing a copy of the NPL issued against the Debtor but that, based on the testimony of Trustee's witness, John Anderson, the burden had shifted back to the Department. The court went on to hold "that the Department ha[d] failed to meet its burden and establish that the Debtor wilfully failed to pay the tax assessed against Chandler for the sale of the aircraft." *Id.* at 1000.

Based principally on the decisions in *Department of Revenue v. Heartland Invest., Inc.*, 106 Ill.2d 19, 86 Ill.Dec. 912, 476 N.E.2d 413 (1985) and *Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 133 Ill.Dec. 647, 541 N.E.2d 858 (4th Dist.1989), the Bankruptcy Court held that in order to establish the element of wilfulness, the Department was required to show a voluntary, conscious, intentional or reckless failure of the Debtor to pay the tax. The court found that the Department had introduced no evidence to support a finding of wilfulness under this standard and, therefore, disallowed the claim on the merits. *Stoecker*, 151 B.R. at 1000.

In its motion to reconsider, the Department argued that it had established its prima facie case of liability against the Debtor by introducing the NPL into evidence and that the burden was thereafter shifted to the Trustee to show a lack of wilfulness. The Bankruptcy Court rejected this argument stating:

> Contrary to the Department's arguments, the Department had the burden of proof to show the Debtor's failure to pay the subject claim was

> willful, rather than the Trustee, as the objector, having the burden to show that the Debtor's failure to pay was not willful. No evidence was adduced by the Department to show that the Debtor's failure to pay the claimed tax was a voluntary, conscious and intentional failure. . . .

Stoecker, 151 B.R. at 1006.

Before this court, the Department argues that it established its prima facie case of the Debtor's liability under section 13½ by submitting the NPL sent to the Debtor. Further the Department argues that the Debtor has failed to rebut the presumption of his liability arising from the Department's prima facie case because the Debtor failed to submit any evidence to the contrary. The Trustee contends that, even if this court finds the NPL deserves a presumption of wilfulness, he introduced uncontroverted evidence that the Debtor's failure to pay the alleged tax was not wilful due to the opinion of outside counsel that the transaction was not subject to the use tax.

Two reported Illinois Appellate Court opinions interpret section 13½ of the ROTA in relation to the evidentiary effect of an NPL issued by the Department.[1] The two cases reach contrary conclusions. The Illinois Supreme Court has not decided this issue.

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[1] On January 1, 1994, section 13½ was replaced by section 3-7 of the Uniform Penalty and Interest Act. (Ill.Rev.Stat. ch., 120, sec. 2603- 7) (now codified as 35 ILCS 735/3-7 (West 1992)). Section 13½ stated the NPL "shall be prima facie proof of the correctness of the penalty due." Section 3-7 now states the NPL "shall be prima facie proof of the correctness for the amount of penalty due."

The Trustee urges this court to follow the recent decision in *Griffith v. Department of Revenue,* 266 Ill.App.3d 838, 203 Ill.Dec. 889, 640 N.E.2d 1262 (1st Dist.1994) delivered by Justice Buckley while the Department urges the court to follow the decision in *Branson v. Department of Revenue,* 268 Ill.App.3d 818, 206 Ill.Dec. 140, 644 N.E.2d 1193 (4th Dist.1994) delivered by Justice Steigmann. Both of these cases were decided after the Bankruptcy Court's decision.

In *Griffith,* the Appellate Court interpreted section 13½ of the ROTA as stating that an NPL is prima facie evidence only of the *amount* due and not of the *wilfulness* of a responsible officer. *Griffith,* 203 Ill.Dec. at 892, 640 N.E.2d at 1265 (emphasis added). Therefore, the court declared that the Department bears the burden of introducing additional evidence to prove wilfulness. The court explicitly rejected the Department's argument that a "prima facie case is met simply by admitting into evidence the reproduced copy of [its] records, i.e., the NPL and Corporate Tax Returns." *Id.* Instead, the court reasoned that the language of the statute reads that the Department's records shall only be prima facie evidence of a penalty due and prima facie proof of the correctness of the penalty. The court refused to equate the meaning of "prima facie case" with the phrases "prima facie evidence of a penalty due" and "prima facie proof of the correctness of the penalty due." *Id.* The court concluded that the meanings of these phrases are not the same and that:

> [t]o hold otherwise would require this court to assume that a person acted wilfully every time the Department's records showed a corporate tax liability. This reading would in effect merge

> the element of wilfulness into the element of corporate liability and would render the wilful language [of the statute] superfluous or meaningless.

Id.

We respectfully disagree with the *Griffith* decision and find Justice Steigmann's reasoning in the *Branson* decision to be more persuasive. In *Branson*, the Appellate Court determined that section 13½ of the ROTA does not limit the prima facie proof to the *amount* of the penalty only. *Branson*, 206 Ill.Dec. at 144, 644 N.E.2d at 1197. The court stated that "the statute provides the introduction of [the NPL] establishes prima facie proof of the correctness of its assessment of a penalty against a taxpayer and, without more, *establishes all the elements necessary for the imposition of a penalty against an individual.*" *Id.*, 206 Ill.Dec. at 143, 644 N.E.2d at 1196 (emphasis added). The court reached this conclusion by analyzing other sections of the ROTA as well as an analogous federal statute.

For example, section 4 of the ROTA, which deals with departmental determinations of the amount of tax due in examining and correcting returns, provides that "Such certified reproduced copy . . . shall be prima facie proof of the correctness of the *amount* of tax due, as shown therein." 35 ILCS 120/4 (emphasis added). Therefore, section 4 indicates that the legislature clearly knew how to limit prima facie determinations to amounts only, in contrast to the existence of the penalty itself.

Additionally, the *Branson* court noted that its interpretation of section 13½ of the ROTA agrees with interpretations of similar federal tax statutes. In interpreting

the meaning of section 13½ of the ROTA, it is appropriate to consider the interpretation given section 6672 of the Internal Revenue Code. *Department of Revenue v. Joseph Bublick & Sons*, 68 Ill.2d 568, 12 Ill.Dec. 265, 369 N.E.2d 1279 (1977). Section 6672(a) of the Internal Revenue Code of 1986 provides that a person responsible for withholding and paying over taxes who wilfully fails to do so is liable for a penalty equal to the total amount of the unpaid taxes. 26 U.S.C.A. § 6672(a) (1989).

In *Brounstein v. United States*, 979 F.2d 952, 954 (3d Cir.1992), the court held that an assessment against a responsible person is equivalent to the assessment of a tax and carries with it a rebuttable presumption that it is correct. Significantly, the court further held that "the IRS's introduction of certified copies of the assessment [at the trial level] shifted to [the taxpayer] the burden of going forward with evidence to show that the assessment against him under 6672 was incorrect by establishing either (1) that he was not a responsible person within the meaning of the statute, or (2) that he did not wilfully fail to pay the amount due to the IRS." *Brounstein*, 979 F.2d at 954; *see also United States v. Schroeder*, 900 F.2d 1144 (7th Cir.1990); *Psaty v. United States*, 442 F.2d 1154 (3d Cir. 1971).

We agree with the *Branson* court's decision which specifically rejected the *Griffith* decision and reasoned that:

> The language of section 13½ of the [ROTA] would be senseless without construing it to mean that the Department's determination was prima facie proof of all elements of the penalty. The Department can assess no penalty without

> finding wilfulness. Thus, in the absence of wilfulness on the part of the responsible individual, the correct amount of any penalty is $0. Accordingly, we hold that the Department's determination of a penalty due against a responsible individual establishes a prima facie case regarding all the statutory elements required for imposition of such a penalty.

Branson, 206 Ill.Dec. at 144, 644 N.E.2d at 1197.

Finally, we are persuaded by the *Branson* court's opinion that it is reasonable to shift the burden to the taxpayer in tax cases. As *Branson* noted, a taxpayer has better access to his or her records and witnesses to rebut the Department's claim of wilfulness.

Accordingly, we find that the Department's determination of a penalty due against a responsible individual establishes a prima facie case regarding all the statutory elements required for imposition of such a penalty.

The Bankruptcy Court's ruling requires this court to remand the action so that the Bankruptcy Court may properly determine whether the Debtor wilfully failed to pay the taxes as assessed against Chandler. The NPL shall be considered prima facie proof of the Debtor's wilfulness which the Trustee will have the burden to rebut. The Bankruptcy Court may wish to re-open the proof so that both parties can introduce evidence in the light of this Supplemental Opinion. After hearing all the evidence offered by the parties, the Bankruptcy Court should determine whether the Trustee successfully proved that the Debtor's inaction was not wilful.

The Trustee also moves this court for certification for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). The Trustee argues that certification is warranted because this court's August 30, 1994 Memorandum, Opinion and Order as well as this Supplemental Memorandum, Opinion and Order involve controlling questions of law as to which there is substantial ground for difference of opinion.

As a general proposition, "permission to take an interlocutory appeal should be granted sparingly and with discrimination." *In re Brand Name Prescription Drugs Antitrust Litigation*, 1995 WL 9216, No. 94 C 897 (N.D.Ill. Jan. 9, 1995) (*quoting In re Folding Carton Antitrust Litigation*, 75 F.R.D. 727, 738 (N.D.Ill.1977)). When deciding a motion for certification, the district court must consider the following factors: (1) whether the motion to be appealed involves a controlling question of law; (2) whether there is a substantial ground for difference of opinion on that question of law; and (3) whether an immediate appeal from the order may materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b); *Segni v. Commercial Office Spain*, 650 F.Supp. 1045, 1046 (N.D.Ill.1987). Although the two issues on appeal in this court involve controlling questions of law on which opinions reasonably differ, we find that an appeal at this time will not materially advance the ultimate termination of this litigation. The ultimate termination of this litigation will be best advanced if the Bankruptcy Court re-decides the issues in the light of this court's Opinions. The parties then can contemplate an appeal. This court will expeditiously decide any appeal made to it so that the parties may swiftly move on to the

Circuit Court of Appeals if either one of them wishes to submit these thorny issues to it.

CONCLUSION

We, therefore, reverse the Bankruptcy Court's decision to disallow the claim on the merits and remand this action to the Bankruptcy Court to determine whether the Debtor was a responsible officer who "wilfully" failed to pay the assessed tax. If the Bankruptcy Court allows the claim, then it must determine whether the claim should be equitably subordinated in accordance with this court's August 30, 1994 Memorandum, Opinion and Order. After these decisions are made, the matter will be ripe for appeal. Accordingly, we deny the motion of the Trustee to certify for interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

It is so ordered.

APPENDIX E

In re William J. STOECKER, Debtor.
Bankruptcy No. 89 B 02873.

United States Bankruptcy Court,
N.D. Illinois, E.D.
Nov. 25, 1992.
Opinion Denying Reconsideration
Feb. 23, 1993.

James D. Newbold, Asst. Atty. Gen., Illinois Dept. of Revenue, Chicago, IL, for Illinois Dept. of Revenue.

Thomas Raleigh, Raleigh & Helms, Chicago, IL, Trustee.

Robert Radasevich, Neal, Gerber & Eisenberg, Chicago, IL, for the trustee.

M. Scott Michel, Chicago, IL, U.S. Trustee.

MEMORANDUM OPINION ON RECONSIDERATION

JOHN H. SQUIRES, Bankruptcy Judge.

This matter comes before the Court on the objection of Thomas E. Raleigh, Chapter 7 trustee (the "Trustee") for the estate of William J. Stoecker (the "Debtor"), to a proof of claim, as subsequently amended, filed by the Illinois Department of Revenue (the "Department"). For the reasons set forth herein, the Court having considered all the pleadings and evidence adduced at trial by way of testimony and exhibits, sustains the objection and disallows the subject proof of claim.

I. *JURISDICTION AND PROCEDURE*

The Court has jurisdiction to entertain this objection to claim pursuant to 28 U.S.C. § 1334 and General Rule 2.33(A) of the United States District Court for the Northern District of Illinois. This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(B).

II. *FACTS AND BACKGROUND*

On February 21, 1989, an involuntary petition under Chapter 11 was filed against the Debtor. Thereafter, on March 20, 1989, the Trustee was appointed Chapter 11 trustee of the estate for cause. On February 26, 1990, the case was converted to Chapter 7. The Trustee remained as the Chapter 7 trustee. Many more of the facts, background and history of this case are contained in earlier Opinions. *See In re Stoecker*, 118 B.R. 596, 598-599 (Bankr.N.D.Ill.1990); *In re Stoecker*, 114 B.R. 965, 967-968 (Bankr.N.D.Ill.1990); *In re Stoecker*, 103 B.R. 182, 184-185 (Bankr.N.D.Ill.1989). Additional background information concerning the related corporate cases is contained in other Opinions of the Court. *See In re Grabill Corp.*, 110 B.R. 356, 358 (Bankr.N.D.Ill.1990); *In re Grabill Corp.*, 103 B.R. 996, 997-998 (Bankr.N.D.Ill.1989).

Upon conversion of the case from Chapter 11 to Chapter 7, the Court by Order dated March 5, 1990, set the 11 U.S.C. § 341 meeting of creditors for March 28, 1990, as required by Federal Rule of Bankruptcy Procedure 2003(a). That Order provided that all proofs of claim were to be filed within ninety days after the section 341 meeting of creditors, on or before June 26, 1990, pursuant to Bankruptcy Rule 3002(c). On November 28,

1990, pursuant to an agreed order, the Debtor's discharge was denied under 11 U.S.C. § 727 in settlement of various filed objections to discharge.

Prior to conversion, the Department filed three proofs of claim on July 25, 1989, when the case was still in its Chapter 11 phase. The first two claims are for withholding tax and Retailers' Occupation/Use Tax (Ill.Rev.Stat. ch. 120, para. 440 *et seq.* and para. 439.1 *et seq.*) owed by the Debtor as responsible officer of The Cook's Cupboard. The amounts of these claims are $12,667.00 and $1,330.21. (Department Exhibit No. 16). The third claim for $222.03 is asserted against the Debtor as responsible officer of Eagle Line, Inc. for Retailers' Occupation/Use Tax. (Department Exhibit No. 16). Thereafter, on November 17, 1989, the Department filed an amended proof of claim, asserting additional taxes owed by the Debtor as responsible officer for The Cook's Cupboard in the amount of $14,630.00. (Answer of Department to Objection to Claim, Exhibit D). The amount of the Department's timely filed proofs of claim totals $14,852.03. No other objections thereto have been filed, thus those claims were deemed allowed under 11 U.S.C. § 502(a) and Bankruptcy Rule 3001(f), although the claims for $1,330.21 and $14,630.00 have been withdrawn by the Department. (Department Exhibit No. 18).

On January 21, 1992, approximately a year and a half after the claims bar date, the Department filed the subject contested proof of claim (Trustee's Objection to Proof of Claim, Exhibit B) which represents Retailers' Occupation/Use Tax allegedly owed by the Debtor as responsible officer for Chandler Enterprises, Inc. ("Chandler"). *See* Ill.Rev.Stat. ch. 120, para. 452 1/2 (1991). The basis of

the claim (subsequently amended to reflect a reduction per an amended claim dated September 3, 1992) arises from Chandler's purchase of an aircraft in 1988. Chandler was an Illinois Corporation, incorporated on January 24, 1985. (Department Exhibit Nos. 19 and 20). The Debtor was president and sole director, but not the sole officer, of Chandler from 1985 to 1990. *Id.* Chandler was involuntarily dissolved by the Illinois Secretary of State on June 1, 1990. (Department Exhibit No. 20, p. 5).

According to the records of the Federal Aviation Administration, Chandler purchased a Dassault Falcon 50 aircraft from Prewitt Leasing, Inc. on September 30, 1988. (Department Exhibit No. 7). The preceding link in the chain of title also showed on that same date, Jack Prewitt & Associates, Inc. sold the aircraft to Prewitt Leasing, Inc., prior to Prewitt Leasing, Inc.'s sale of the aircraft to Chandler. (Department Exhibit No. 6). The aircraft was previously sold to Jack Prewitt & Associates, Inc. on June 1, 1988, by Opex Aviation, Inc. (Department Exhibit Nos. 5 and 5A). The aircraft was subsequently leased by Chandler to Grabill Corporation for the period of September 30, 1988 through December 30, 1988, at a basic monthly rental of $172,752.25. (Department Exhibit No. 8, p. 00000002332).

Neither Chandler nor Prewitt Leasing, Inc. paid any sales/use tax, withholding tax or income tax on Chandler's purchase of the aircraft. John Anderson, counsel for Chandler and Grabill, issued an opinion concluding that under Illinois law, there was no sale or use tax properly assessable or payable as a result of the purchase of the aircraft by Chandler or the lease of the aircraft by Chandler to Grabill. (Trustee Exhibit No. 3). Such legal

opinion was supported by the vice-president of Prewitt Leasing, Inc. who signed a "Certificate Re Occasional Seller Exemption from Illinois Sales and Use Tax" on September 30, 1988. (Trustee Exhibit No. 4).

On March 7, 1990 and June 7, 1990, weeks before the claims bar date, the Department sent Chandler two letters demanding payment of the claimed tax due. (Trustee Exhibit Nos. 3 and 4). Subsequently, on September 7, 1990, a Notice of Penalty Liability was issued against Chandler. (Department Exhibit No. 10). Almost one year later, on August 15, 1991, a Notice of Penalty Liability was issued against the Debtor. (Department Exhibit No. 1). On September 25, 1991, the Department sent the Debtor a demand for full payment of the tax liability claimed. (Department Exhibit No. 13). The Trustee subsequently objected to allowance of this late filed claim pursuant to Bankruptcy Rule 3007. On July 30, 1992 and August 27, 1992, the Court held the trial on this matter. Thereafter, the matter was taken under advisement after submission of post-trial briefs.

III. *ARGUMENTS OF THE PARTIES*

The Trustee has objected to the late filed claim of the Department on two grounds: (1) the claim was filed after the bar date fixed by Bankruptcy Rule 3002(c), and hence is untimely; and (2) the claim against the Debtor as responsible officer of Chandler is invalid as the underlying purchase of the aircraft by Chandler was an "occasional sale" exempt from sales/use tax.

The Department does not deny that its claim filed on January 21, 1992 is untimely. Instead, the Department

contends that the claim should be treated as an amendment to the earlier filed proofs of claim pursuant to Federal Rule of Civil Procedure 15. In the alternative, the Department requests the Court utilize its equitable powers to allow the claim though late filed. The Department explains that it failed to file a timely claim against the Debtor as responsible officer of Chandler because Chandler never registered with the Department for any type of tax, and never filed a tax return with the Department during its corporate existence. By the time the Department discovered that Chandler was engaged in taxable activities and that the Debtor was a responsible officer of Chandler, the claims bar date had passed. The Department maintains, however, that by previously filing responsible officer tax claims, it has clearly evidenced its intention of claiming any and all responsible officer liability against the Debtor and his bankruptcy estate.

The Department contends its efforts to file a timely claim were impeded as a result of Chandler's conduct and omissions. It alleges that Chandler acted improperly in failing to register with the Department or file tax returns regarding its purchase and lease of the aircraft. Moreover, the Department contends that Chandler attempted to conceal the taxability of the transaction by having title to the aircraft transferred from Jack Prewitt & Associates, Inc., a retail seller of aircraft, to Prewitt Leasing, Inc., a purported lessor of aircraft, so that it could claim the "occasional sale" exemption.

The Trustee contends that the sale of the aircraft to Chandler was an "occasional sale" of property at retail, exempt from sales/use tax. The Trustee argues that Anderson's opinion letter properly concluded that the

transaction was exempt from taxes. The Department disagrees with this contention and claims that in order to create a sale that was ostensibly exempt from tax, Jack Prewitt & Associates, Inc. sold the aircraft to Prewitt Leasing, Inc. who in turn acted as a nominal "straw man" and immediately thereafter sold it to Chandler. The Department contends the true seller was Jack Prewitt & Associates, Inc., and that the sale was not an "occasional sale" exempt from tax.

IV. *APPLICABLE STANDARDS*

Pursuant to Federal Rule of Bankruptcy Procedure 3002(c), a creditor in a Chapter 7 case is required to file a proof of claim within ninety days after the date first set for the meeting of creditors called under 11 U.S.C. § 341. There are several specific instances where the time for filing proofs of claim may be extended in a Chapter 7 case, none of which are applicable here. *See* Fed.R.Bankr.P. 3002(c). Thus, Bankruptcy Rule 3002(c)(1) requires that a claimant, like the Department, must first move for an extension within the permitted ninety days, which it did not do. The Court's authority to extend the time for filing proofs of claim is also severely limited by Bankruptcy Rule 9006. Pursuant to Bankruptcy Rule 9006(b)(3), the Court is allowed to extend the time for creditor/claimants taking action under Bankruptcy Rule 3002 only "to the extent and under the conditions stated in [the rule]." Fed.R.Bankr.P. 9006(b)(3). Thus, "Bankr.R. 3002(c) is strictly construed as a statute of limitations since the purpose of such a claims bar date is 'to provide the debtor and its creditors with finality' and to 'insure the swift distribution of the bankruptcy estate.' " *In re*

Robert Stone Cut Off Equipment, Inc., 98 B.R. 158, 160 (Bankr.N.D.N.Y.1989) (quoting *In re Johnson*, 84 B.R. 492, 494 (Bankr.N.D.Ohio 1988) and *In re Good News Publishers, Inc.*, 33 B.R. 125, 126 (M.D.Tenn.1983)). *See also In re Chirillo*, 84 B.R. 120, 121-122 nn. 2-3 (Bankr.N.D.Ill.1988) (collecting cases).

Bankruptcy Rule 3002(c) can operate in conjunction with Federal Rule of Bankruptcy Procedure 7015 which incorporates by reference Federal Rule of Civil Procedure 15. Rule 15(c) provides in pertinent part:

> An amendment of a pleading relates back to the date of the original pleading when
>
> . . .
>
> (2) the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading. . . .

Fed.R.Civ.P. 15(c). Bankruptcy Rule 7015 provides that "Rule 15 FR Civ P applies in adversary proceedings." Fed.R.Bank.P. 7015. While normally an objection to a claim is not a formal adversary proceeding, Bankruptcy Rule 9014 allows courts at any stage of a contested motion or other matter, to extend Bankruptcy Rule 7015, among other rules, to contested matters which includes the Trustee's objection to the Department's claim. *See In re Unroe*, 937 F.2d 346, 349 (7th Cir.1991). No such order or direction was made in this matter pursuant to Bankruptcy Rule 9014.

The decision to allow an amendment to a proof of claim is within the sound discretion of the Court. *In re Stavriotis*, 977 F.2d 1202, 1204 (7th Cir.1992); *Unroe*, 937

F.2d at 350; *In re Candy Braz, Inc.*, 98 B.R. 375, 380 (Bankr.N.D.Ill.1988). Amendments to timely filed claims are liberally allowed to modify information or correct omissions in the original claim. *In re Calisoff*, 94 B.R. 1002, 1003 (Bankr.N.D.Ill.1988). Amendments to proofs of claim are also permitted if "the original claim provided notice to the court of the existence, nature and amount of the claim and that it was the creditors' intent to hold the estate liable." *In re International Horizons, Inc.*, 751 F.2d 1213, 1217 (11th Cir.1985). Amendments to claims are closely scrutinized to ensure that the amendment is genuine rather than an assertion of an entirely new claim. *Candy Braz*, 98 B.R. at 380; *In re AM International, Inc.*, 67 B.R. 79, 81 (N.D.Ill.1986). "[T]o be within the scope of a permissible amendment, the second claim should not only be of the same nature as the first but also reasonably within the amount to which the first claim provided notice." *Id.* at 82.

"[B]ankruptcy courts are not required to permit late amendments which are primarily used as a back-door route to secure bar-date extensions. Were the rule otherwise, a party could effectively help itself to automatic extensions of the bar date without seeking leave of the court." *Stavriotis*, 977 F.2d at 1206. While leave to amend should generally be granted, courts have found it inappropriate in some circumstances. *See Amendola v. Bayer*, 907 F.2d 760, 764 (7th Cir.1990) (denial of leave to file amended claim affirmed where party was aware of the facts underlying the claim prior to the filing deadline and presented no excuse for failing to raise the claim earlier; opposing party would be unduly prejudiced; and delay would impair the public interest in prompt resolution of

disputes). "[U]nlike a chapter 11 proceeding, the court reviewing a chapter 7 or chapter 13 proof of claim has no discretion to allow an untimely filed claim on the grounds of excusable neglect." *In re Couzens Warehouse & Distributors, Inc.*, 1991 WL 233314 at *1, 1991 Bankr. LEXIS 1591 at *2 (Bankr.N.D.Ill. Oct. 17, 1991); *In re Smartt Constr. Co.*, 138 B.R. 269, 271 (D.Colo.1992) ("A majority of courts agree that the bar date for Chapter 7 and Chapter 13 proofs of claim cannot be extended for excusable neglect.").

The Court's authority to allow the late filed claim of the Department is not absolutely limited by statute or rule. Another potential basis for allowing the claim is the Court's equitable powers. This authority was recently discussed by the Seventh Circuit Court of Appeals in *Unroe*, 937 F.2d 346, which noted, "[e]quitable jurisdiction to permit amendments out-of-time does not conflict with, but rather fulfills, the statutory backdrop for bankruptcy proceedings. The bankruptcy court below therefore properly considered equitable matters outside the scope of the test of Fed.R.Civ.P. 15(c) in deciding to permit the late-filed claim as an 'amendment.' " *Id.* at 349-350. The *Unroe* court expressly stated, however, that late filed claims disrupt orderly discharge and should generally be barred. *Id.* at 351.

In *Unroe*, the court permitted the late filing of a claim for income taxes which had been scheduled at a higher amount in the debtor's Chapter 13 plan. The debtor included in her plan of confirmation $15,000.00 for taxes owed for the years 1982 and 1983. The IRS filed a timely proof of claim for 1982 taxes, but failed to file a claim for 1983 taxes until after the claims bar date. The sum total

for both 1982 and 1983 taxes sought by the IRS in its untimely amendment, however, was $10,914.21, approximately $4,000.00 less that the $15,000.00 the debtor listed as tax liabilities. The court found that neither the debtor nor the creditors were prejudiced by the allowance of the late filed claim for the 1983 taxes. The court stated, however, that "[t]he result may have been different had the late claim been unscheduled or exceeded the amount in the plan, in which cases the prejudice to the debtor and other creditors would have been more severe." 937 F.2d at 351.

In holding that the bankruptcy courts' equitable powers included the authorization of late filed claims, *Unroe* noted that such an exercise of equity must include identification of factors related to the debtor's notice of a pending claim or excusable neglect by the creditor. *Id.* at 350 n. 5. The holding in *Unroe*, however, did not extend to an entirely new claim filed after the bar date. Specifically, the court noted, "[w]e leave for another case the question whether a judge in equity could permit an entirely new claim filed out of time." *Id.* at 350.

Another contrary approach has been taken by the United States Bankruptcy Court for the District of Minnesota, sitting *en banc* in *In re Hausladen*, 146 B.R. 557 (Bankr.D.Minn.1992). There the court principally focused on the absence of an exception under section 502 for late claims as a basis for disallowance. *Hausladen* involved late filed Chapter 13 claims subject to the same bar date period prescribed by Bankruptcy Rule 3002(c). There, the court noted that Rule 3002 does not explicitly state that timely filing is a prerequisite to allowance and that section 502(b) does not specify tardiness in filing as one of

the eight statutorily enumerated grounds for disallowing claim. In discussing various ways a tardily-filed claim may be treated under a Chapter 13 plan, the court aptly noted that treatment or classification of claims is different from their allowance. 11 U.S.C. § 726, however, provides for distribution of property of the estate and that timely filed claims enjoy priority in distribution over tardily-filed claims. *Compare* 11 U.S.C. § 726(a)(2) with (a)(3). In most Chapter 7 cases, like this one, a claim holder's "rung" on the priority "ladder" created under section 726 is crucial because the estate assets are limited. There are usually insufficient assets to pay all claimants in full, and section 726(b) mandates pro rata distribution among all claimants at each level, or rung of the priority ladder, with an absolute priority cutoff. All allowed claimants at a particular level or rung of the ladder must be paid in full before any estate funds can be distributed to holders of claims at the next lower rung. Thus, the race among claimants is to reach the highest rung on the claims ladder.

Hausladen is premised upon the proposition that the time limits of Rule 3002(c) cannot be imposed on the exceptions to allowance provided in the statutory language of section 502(b). The rule, however, setting a limitations period does not necessarily conflict with the statute because the latter is silent on tardily-filed claims. Section 502(b)(1) does state an exception of claims unenforceable "against the debtor . . . under any . . . applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. § 502(b)(1). Such exception logically includes the applicable law of the claims bar

date established by Bankruptcy Rule 3002(c), promulgated by the Supreme Court of the United States pursuant to the congressional authority granted it by the Rules Enabling Act. *See* 28 U.S.C. § 2075. Thereby, Congress has at least tacitly allowed the Supreme Court to prescribe the applicable statute of limitations contained in Bankruptcy Rule 3002. As a general proposition, statutes of limitation are to be strictly construed. *See In re Friedman*, 15 B.R. 493, 494 (Bankr.N.D.Ill.1981). This principle is appropriately applied in light of the text of Bankruptcy Rule 9006(b). Accordingly, the Court will follow the rationale behind *Chirillo*, as tempered by *Unroe* and *Stavriotis* which are binding precedents in this circuit, while *Hausladen* is not. Thus, the Court declines to follow *Hausladen*.

The Department alternatively relies on the equitable factors enumerated in *In re Miss Glamour Coat Co.*, 80-2 U.S.T.C. ¶ 9737 (S.D.N.Y.1980). *Unroe* recognized the applicability of these factors. 937 F.2d at 350-351. Pursuant to *Miss Glamour Coat*, a court may, in its discretion, allow a late filed proof of claim. The factors that must be considered include the following:

> (1) whether the parties or creditors relied on the Department's initial claim, or whether they had reason to know subsequent proof of claim would follow pending the completion of the audit;
>
> (2) whether other creditors would receive a windfall to which they are not entitled on the merits by the court not allowing this amendment to the Department's proof of claim;

(3) whether the Department intentionally or negligently delayed in filing its amended claim;

(4) the justification, if any, for the failure to request a timely extension of the bar date; and

(5) any other general equitable considerations.

Id. at 85, 434-435.

V. *DISCUSSION*

A. Whether the Department's Claim Should be Deemed or Allowed as Timely Filed

The Trustee alleges that because the Department's proof of claim was filed after the bar date, and because the Department never asked for an extension of time to file its proof of claim before the expiration of the bar date as required by Bankruptcy Rules 3002(c)(1) and 9006(b)(3), the claim must be disallowed as untimely. The Court agrees and hereby finds that the Department's claim was admittedly tardily-filed. The Department could have timely moved for an extension of time within the ninety day period as contemplated by Bankruptcy Rule 3002(c)(1). It failed to so move, and hence pursuant to Bankruptcy Rules 3002(c) and 9006(b)(3) the Court will not allow the claim as timely filed.

Moreover, viewed under Rule 15(c), the Court finds that the late filed claim did not arise out of any of the same transactions or occurrences set forth in the four timely claims filed by the Department before the bar date. None of those claims concerned taxes owed by Chandler or the Debtor as a responsible officer of that entity. The Department's purported amendment arises out of a tax

imposed against an entirely different entity than any referenced in its timely filed claims. Additionally, the Court finds that the instant late filed claim is for an amount greatly exceeding the aggregate of all its timely filed claims. Thus, the Court concludes that the subject proof of claim is not a proper amendment to any of the earlier filed proofs of claim, but rather an entirely new claim. *See e.g., Am International*, 67 B.R. at 82 (a claim for approximately $11,000.00 does not give parties notice of a claim of over $2,000,000.00, even though the creditors had notice that the amount of taxes had not yet been determined).

Furthermore, the Department contends that by timely filing claims against the Debtor as a responsible officer of The Cook's Cupboard and Eagle Line, Inc., it demonstrated an intent to assert claims against the Debtor and the estate for any liability the Debtor has as a responsible officer for any type of trust fund tax for which it could make a personal claim against him. The Court finds this argument unpersuasive. Taken to its logical conclusion, this argument purports to put the estate, and all its other creditors, on sufficient notice of any and all taxes due and owing by the Debtor from any corporation of which the Debtor was a responsible officer. While the filing of the previous claims against the Debtor as responsible officer of those other corporations may be a clear indication of the Department's intent to hold the Debtor responsible for taxes in those corporations, the Court is not willing to extend this argument as effective notice to all other parties in interest concerning any and all other corporations of which the Debtor may potentially be held to be a responsible officer for sales or use taxes in unspecified

amounts. Accordingly, the Court hereby declines to allow the Department to amend its earlier proofs of claim pursuant to Bankruptcy Rule 7015.

In addition, the Court declines to allow the late filed claim under its equitable power and exercise of discretion as set forth in *Unroe* and *Stavriotis*. The Court respectfully distinguishes the result reached here with that in the *Unroe* and *Stavriotis* decisions. First, neither *Unroe* nor *Stavriotis* made reference to Bankruptcy Rule 9006(b)(3), which allows extensions of time only and to the extent provided in Bankruptcy Rule 3002(c). The Court views such omission to reference the mandatory limits of Rule 9006(b)(3) as a major limitation in the appropriate application of those decisions. Moreover, in *Unroe* the debtor scheduled the IRS for a larger amount than the actual amount finally claimed, in contrast to the facts of this matter where the Debtor, at all times, asserted his Fifth Amendment privilege against self-incrimination, and never filed schedules of assets or liabilities. Thus, the Trustee and the interested creditors were left to their own resources to ferret out the Debtor's liabilities, including the instant contested claim which only surfaced of record over a year after the claims bar date had run.

Next, in applying the *Glamour Coat* balancing test, which *Unroe* adopted, the Court concludes that the equities weigh in favor of disallowance of the subject claim. No evidence in the record offers any compelling explanation for the Department's failure to request an extension of the bar date. The Department was a scheduled creditor, received notice of the claims bar date, and timely filed four proofs of claim. The Department filed the late claim one and a half years after the bar date. Moreover, the

Court finds that the Department did not exercise due diligence in filing its claim. Pursuant to the testimony of Mark Russell, a revenue auditor for the Department, the investigation of the September 1988 aircraft transfer did not begin until February or March 1990, months prior to the claims bar date. The evidence adduced at trial indicated that the Department was well aware of the pendency of this case. Russell further testified that he was aware in July 1990 that the Debtor was the president of Chandler. The Department, however, did not send out a Notice of Penalty Liability to the Debtor until August 15, 1991. It subsequently waited until January 21, 1992 to file the subject proof of claim. The Court concludes that these belated actions do not constitute due diligence.

Although the Department's actions for purposes of assessment under the Retailers' Occupation/Use Tax Acts may be timely and within the applicable statute of limitations, that is insufficient on these facts to establish the requisite diligence for timely filed bankruptcy proofs of claim as required under Bankruptcy Rules 3002(c) and 9006(b)(3). The Court similarly rejects the Department's arguments that employees of one of its units were unaware of what other employees in its other units were doing. This is a classic bureaucratic excuse that the right hand was unaware of what the left hand was doing or had done. The applicable Bankruptcy Rules do not provide for such an exception. Bankruptcy Rule 3002(c)(1) merely contemplates a timely motion for an extension of time which could have been requested, but was not sought. The Department is the claimant, however, not its various units or employees, and as an entity and claimant is held to the requirements of the Bankruptcy Rules.

In addition, nothing in the record indicates that the Trustee or other interested parties were on notice that there would be any additional claims for taxes due and owing by Chandler, a corporation which was not mentioned in any of the Department's timely filed proofs of claim. Furthermore, no creditor will receive a windfall if the subject contested claim is disallowed. The Trustee has estimated that the unsecured creditors in the estate will receive approximately a twenty percent dividend distribution.

The Department claims the timely filed proofs of claim covered the taxable period of July, 1986 through July, 1989, and the amended claim at issue is for the period of September, 1988. The Department further argues that its efforts to timely file a claim were impeded because Chandler attempted to conceal the taxability of the transaction by having title to the airplane transferred from the retailer, Jack Prewitt & Associates, Inc. to Prewitt Leasing, Inc. so that it could claim the "occasional sale" exemption. The Department claims that it did not file a timely claim with regard to the aircraft purchase because Chandler never registered with the Department for any type of tax and never filed a tax return with the Department during its corporate existence. Russell, however, admitted that a corporation is not required to register or to file a tax return if it has no income and has not engaged in a taxable transaction. The Department counters that Chandler was seeking to evade payment of the tax. The Court finds this argument misplaced. The Department cannot assert Chandler's acts or omissions as a compelling defense for its own inaction under the facts of this matter in light of the history of the Department's

timely prior actions in connection with its other claims in this case. In the pleadings, the Department sets forth the proposition and cites supporting cases that concealment of a cause of action suspends the running of applicable statutes of limitations. Although the Department is contending that the Debtor and Chandler fraudulently concealed the taxability of the subject transaction, no evidence of fraud or conspiracy was presented supporting this conclusion. Therefore, the Court will not further address this argument and rejects same.

Upon balancing the equities, the Court finds that the equities really favor the other unsecured creditors whose allowed claims were timely filed and whose dividends should not be diluted through allowance of the subject contested claim. After all, the Department has other potential sources of recovery for its assessed unpaid taxes, namely Chandler and its assets, if any, other potentially responsible officers of Chandler and their assets, and the Debtor and his assets as a result of the denial of his discharge.

B. *The Underlying Claim Against the Debtor as Responsible Officer of Chandler*

Concerning the Trustee's second defense attacking the merits of the Debtor's liability for the Department's claim, the Court must first address the Department's contention that this Court lacks jurisdiction to determine the tax liability of a non-debtor entity such as Chandler. For this proposition, the Department cites several cases. *See In re Brandt-Airflex Corp.*, 843 F.2d 90 (2d Cir.1988); *United States v. Huckabee Auto Co.*, 783 F.2d 1546 (11th

Cir.1986); *In re Success Tool & Mfg. Co.*, 62 B.R. 221 (N.D.Ill.1986). These cases are distinguishable from the case at bar. In the cited cases, the debtors sought to have the court shift a tax liability to a non-debtor. That is not the situation in this matter. Thus, the Court declines to follow this inapposite line of authority.

Pursuant to 11 U.S.C. § 505(a)(1), the Court is authorized to "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." Several courts have held that the bankruptcy court may apply section 505(a) to determine the tax liability of parties other than the debtor. *See In re Wolverine Radio Co.*, 930 F.2d 1132 (6th Cir.1991), *cert. denied*, ___ U.S. ___, 112 S.Ct. 1605, 118 L.Ed.2d 317 (1992) (bankruptcy courts have jurisdiction over disputes involving unemployment compensation tax liability incurred by debtors, but same may include tax disputes concerning non-debtors when that dispute affects the debtors and when exercise of that jurisdiction is necessary to rehabilitate the debtor or to administer its estate effectively); *In re Goldblatt Bros., Inc.*, 106 B.R. 522 (Bankr.N.D.Ill.1989) (court held that determination of whether creditors' committee was responsible for paying taxes on interest earned on money held in an account established pursuant to the Chapter 11 plan was a core proceeding); *In re John Renton Young, Ltd.*, 87 B.R. 635 (Bankr.D.Nev.1988) (court had jurisdiction to determine debtor's motion for injunctive relief from a one-hundred percent penalty tax assessment against the non-debtor obligor based on his relationship with the

debtor as its president and only shareholder); *In re Jon Co.*, 30 B.R. 831 (D.Colo.1983) (court determined the 26 U.S.C. § 6672 tax liability of the debtor's employees); *In re H & R Ice Co.*, 24 B.R. 28 (Bankr.W.D.Mo.1982) (same); *In re Major Dynamics, Inc.*, 14 B.R. 969 (Bankr.S.D.Cal.1981) (court stayed IRS audits, assessments and collections directed at the creditors of the estate). In *Major Dynamics*, the court acknowledged that the legislative history of section 505 focuses on tax obligations of the debtor or the debtor's estate. It held, however, that the "any tax" language used in section 505(a)(1) must control and "that the Bankruptcy Court has jurisdiction to determine disputes between third party creditors and the IRS in an appropriate case." 14 B.R. at 972. The court opined that an "appropriate case" included "tax disputes of third parties other than the debtor *provided, however*, that the IRS activity to be enjoined directly affected the debtor or the estate, and that the exercise of such jurisdiction was necessary to the rehabilitation of the debtor or the orderly and efficient administration of the debtor's case." *Id.* (emphasis in original).

In the instant matter, the parties ask the Court to determine the Debtor's liability as responsible officer of a non-debtor corporation. The Debtor's liability, in part, depends on whether Chandler actually owes the tax. The determination of the tax assessed against Chandler directly affects the Debtor, who was denied a discharge, and the potential dividend distribution from the estate. Moreover, the determination of this issue is necessary for the orderly and efficient administration of the estate. *See Major Dynamics*, 14 B.R. at 972. Having been denied a discharge, the Debtor has a personal stake in the outcome

of Chandler's (and his) tax liability. *See Jon Co.*, 30 B.R. at 833-834. Thus, under the plain language used in section 505(a)(1), the Court can examine the asserted tax liability of Chandler. *See e.g., Wolverine Radio*, 930 F.2d at 1140-1143. Moreover, under 11 U.S.C. § 558, the Trustee may assert any defense available to the Debtor for the benefit of the estate including defenses personal to the Debtor. Thus, even though the Debtor may not have protested the notice of assessment sent by the Department to him, the Trustee may still assert substantive defenses to the claim as argued here. *See* 11 U.S.C. § 558.

The Department asserts and has assessed personal liability on the Debtor as a corporate officer of Chandler pursuant to Section 13½ of the Retailers' Occupation Tax Act, which provides in pertinent part:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed . . . and who willfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon. . . .

Ill.Rev.Stat. ch. 120, para. 452½ (1991).

The Illinois Supreme Court has held that the willful failure to pay requirement is satisfied with a showing of "voluntary, conscious and intentional failure" to make the tax payments. *Department of Revenue v. Heartland Invest., Inc.*, 106 Ill.2d 19, 30, 86 Ill.Dec. 912, 476 N.E.2d 413 (1985)

(quoting *Department of Revenue v. Joseph Bublick & Sons, Inc.*, 68 Ill.2d 568, 577, 12 Ill.Dec. 265, 369 N.E.2d 1279 (1977)); *Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 583-584, 133 Ill.Dec. 647, 649, 650, 541 N.E.2d 858, 860, 861 (4th Dist.1989). Moreover, "in a civil action, wilful conduct does not require bad purpose or intent to defraud the government." *Heartland Invest.*, 106 Ill.2d at 30, 86 Ill.Dec. 912, 476 N.E.2d 413. The *Bublick* court further found that the determination of willful failure "is an issue of fact to be determined by the trier of the fact on the basis of the circumstances and evidence adduced in the particular case." *Bublick*, 68 Ill.2d at 577, 12 Ill.Dec. 265, 369 N.E.2d 1279.

The Retailers' Occupation Tax Act further establishes the procedure for creating and assessing the liability against a corporate officer:

> The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of such determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or any legal proceeding and shall be prima facie proof of the correctness of the penalty due, as shown thereon.

Ill.Rev.Stat. ch. 120, para. 452½.

The Department established prima facie proof of the correctness of the penalty by introducing a copy of the Notice of Penalty Liability issued against the Debtor. (Department Exhibit No. 1). At trial, the Trustee presented evidence to the contrary, namely the opinion testimony of John Anderson which concluded the sale was not taxable, as well as the supporting certificate of occasional seller exemption executed on behalf of Prewitt Leasing, Inc. As a result of this evidence, the ultimate burden of proof and persuasion shifted back to the Department. *See generally, People ex rel. Dept. of Revenue v. National Liquors Empire, Inc.*, 157 Ill.App.3d 434, 439, 109 Ill.Dec. 627, 630-631, 510 N.E.2d 495, 498-499 (4th Dist.1987). The Department's assessment notice to the Debtor and the prima facie effect of para. 452½ without more evidence are insufficient. Even proof that Chandler may be liable for the tax is not ipso facto sufficient to show the Debtor liable as a responsible officer.

The Court finds that the Department has failed to meet its burden and establish that the Debtor willfully failed to pay the tax assessed against Chandler for the sale of the aircraft. On the required element of corporate control, it is uncontested that the Debtor was president and sole director of Chandler. Although by no means certain, the Court can reasonably infer that the Debtor, as such officer and director, was in control of Chandler. No compelling evidence, however, was presented on the issue of whether the Debtor's failure to pay the claimed tax was voluntary, conscious and intentional. John Anderson testified that Lawrence Pluhar acted as the Debtor's chief financial officer, and thus is putatively another potential responsible Chandler officer against whom the

Department could proceed. Chandler's annual corporate report for 1988 showed two other officers who may be additional potentially responsible officers. (Department Exhibit No. 19, p. 3). There was no evidence presented of the Debtor's voluntary, conscious and intentional failure to pay the tax. Evidence that the Department sent the notice of assessment to the Debtor, and he has not paid same or responded to the Department's demands, is not the equivalent of a conscious or intentional failure on his part.

As a matter of law, the automatic stay under 11 U.S.C. § 362(a) was effective from the time the petition was filed in February, 1989, over two years prior to the Department's August 15, 1991 issuance of its Notice of Penalty Liability to the Debtor. That his pre-petition property which passed to the Trustee as property of the bankruptcy estate under 11 U.S.C. § 541 was not available to satisfy this contested claim, does not serve as the equivalent of adequate proof of the Debtor's voluntary, conscious and intentional failure to pay.

In addition, in *Corrosion Systems*, the corporate officer against whom the Department sought to impose responsible party liability, signed the corporation's tax reports and checks accompanying same. 185 Ill.App.3d at 5[illegible]3-584, 133 Ill.Dec. at 650, 541 N.E.2d at 861. The court there concluded, however, that "the officer had relied on his accountant, and there was no evidence 'that the defendant consciously, voluntarily, intentionally, knowingly or recklessly failed to make the appropriate retailers' occupation tax payments.' " *Id.* (quoting *Department of Revenue v. Marion Sopko, Inc.*, 84 Ill.App.3d 953, 955, 40 Ill.Dec. 487, 489, 406 N.E.2d 188, 190 (2d

Dist.1980)). Based upon the evidence that the Debtor has merely failed to respond to the Department's notice, the Court is unable to conclude that the Debtor's failure to pay the tax was willful or voluntary, conscious and intentional.

VI. *CONCLUSION*

For the reasons set forth herein, the Court hereby sustains the Trustee's objection to the allowance of the Department's subject proof of claim, as amended.

This Opinion serves as findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

MEMORANDUM OPINION

This matter comes before the Court on the motion for reconsideration filed by the Illinois Department of Revenue (the "Department") of the Court's Memorandum Opinion and Order dated November 25, 1992, and the response in opposition filed by Thomas E. Raleigh, Chapter 7 Trustee (the "Trustee"). For the reasons set forth herein, the Court hereby denies the motion.

I. *JURISDICTION AND PROCEDURE*

The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334 and General Rule 2.33(A) of the United States District Court for the Northern District of Illinois. This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(B).

II. *APPLICABLE STANDARDS*

"Motions to reconsider" are not formally designated by either the Federal Rules of Bankruptcy Procedure or Federal Rules of Civil Procedure, except as provided in 11 U.S.C. § 502(j) and Bankruptcy Rule 3008 which allow reconsideration of orders allowing or disallowing claims against the estate. Section 502(j) provides in relevant part that "[a] claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case." 11 U.S.C. § 502(j). Bankruptcy Rule 3008, in turn, provides that "[a] party in interest may move for reconsideration of an order allowing or disallowing a claim against the estate. The court after a hearing on notice shall enter an appropriate order." Fed.R.Bankr.P. 3008. Reconsideration of both allowed and disallowed claims may be made at any time before the case is closed. *In re Resources Reclamation Corp.*, 34 B.R. 771, 773 (Bankr.9th Cir.1983). The Court should weigh the extent and reasonableness of any delay, prejudice to the debtor and other creditors, effect on efficient administration, and the moving creditor's good faith. *Id.* Rule 3008 has been held permissive and does not require that a party file a motion to reconsider before appealing. *Walsh Trucking Co. v. Insurance Co. of North America*, 838 F.2d 698 (3rd Cir.1988).

The Seventh Circuit Court of Appeals has instructed courts to treat all substantive post-judgment motions filed within ten days of judgment under Rule 59. *Charles v. Daley*, 799 F.2d 343 (7th Cir.1986). Motions made thereafter are considered under the provisions of Rule 60 of the Federal Rules of Civil Procedure, as adopted by Bankruptcy Rule 9024. Because the motion at bar was filed and

served on December 4, 1992, within ten days of the judgment, the procedural standards and authorities construing section 502(j) and Rules 59, 3008 and 9023 control.

Motions made under Rule 59 serve to correct manifest errors of law or fact, or to consider the import of newly discovered evidence. *Publishers Resource, Inc. v. Walker-Davis Publications, Inc.*, 762 F.2d 557 (7th Cir.1985); *Keene Corp. v. International Fidelity Ins. Co.*, 561 F.Supp. 656 (N.D.Ill.1982), *aff'd*, 736 F.2d 388 (7th Cir.1984); *F/H Industries, Inc. v. National Union Fire Ins. Co.*, 116 F.R.D. 224, 226 (N.D.Ill.1987). The function of a motion made pursuant to Rule 59(e) is not to serve as a vehicle to relitigate old matters or present the case under a new legal theory. *Federal Deposit Ins. Corp. v. Meyer*, 781 F.2d 1260, 1268 (7th Cir.1986); *Evans, Inc. v. Tiffany & Co.*, 416 F.Supp. 224, 244 (N.D.Ill.1976); *In re BNT Terminals, Inc.*, 125 B.R. 963, 976-977 (Bankr.N.D.Ill.1990). The purpose of a motion to alter or amend "is not to give the moving party another 'bite at the apple' by permitting the arguing of issues and procedures that could and should have been raised prior to judgment." *BNT Terminals*, 125 B.R. at 977. "A motion brought under Rule 59(e) is not a procedural folly to be filed by a losing party who simply disagrees with the decision; otherwise, the Court would be inundated with motions from dissatisfied litigants." *Id.*

III. *THE DEPARTMENT'S ARGUMENTS*

The Department makes several arguments in its motion. First, it contends that Bankruptcy Rule 3002(c) conflicts with 11 U.S.C. § 726(a)(2) and (a)(3), the statutory provision governing payments of claims, because it

specifically contemplates allowance of late-filed claims by providing for their payment. Second, the Department argues that pre-petition unsecured priority claims that would be so classified under 11 U.S.C. § 507(a)(7), even if late-filed, such as the claim at bar, are entitled to payment and distribution along with timely filed pre-petition unsecured claims under section 726(a)(1). This is so, the Department maintains, because the text of section 726(a)(1) makes no reference to effectively subordinated dividend distributions of late-filed priority claim; section 726(a)(2) is explicitly inapplicable to priority claims by its text; and the provisions of section 726(a)(3) likewise do not specifically exclude claims that would otherwise be accorded administrative priority under section 507. Only claims of general unsecured creditors who file late claims receive distribution under section 726(a)(3).

Next, the Department urges the Court to follow the recent opinion of Judge Wedoff in *In re Rago*, 149 B.R. 882 (Bankr.N.D.Ill.1992) which followed *In re Hausladen*, 146 B.R. 557 (Bankr.D.Minn.1992). *Hausladen* held that late filing of a claim is not grounds for its disallowance under section 502(b). *Rago*, in turn, held that priority claims, even though late filed, are entitled to distribution under section 726(a)(1). The Department concludes that these two opinions are recent significant changes in extant case law concerning contested late claims allowance and payment, and the Court should follow these decisions by holding Bankruptcy Rule 3002(c) invalid as in conflict with sections 502(b) and 726. The Department concludes that because section 726(a)(2)(C) and (a)(3) provide for

payment of late-filed claims, they conflict with and override the provisions of Bankruptcy Rule 3002(c), notwithstanding the Seventh Circuit cases which do not address the perceived conflict, but assume the validity of the Rule. The Department contends that in the Chapter 7 context, there is no legal dispute that late claims are allowed. The real issue is classification for distribution purposes.

Lastly, concerning the merits of the underlying claim, the Department argues it established and proved a prima facie case, notwithstanding the Trustee's evidence and objections thereto, citing as supporting authority two Illinois Appellate Court decisions: *Quincy Trading Post, Inc. v. Department of Revenue*, 12 Ill.App.3d 725, 298 N.E.2d 789 (4th Dist.1973) and *Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 133 Ill.Dec. 647, 541 N.E.2d 858 (4th Dist.1989). The Court notes that it discussed and applied *Corrosion Systems* in its prior Opinion. Under this argument, the Department asserts that because the Trustee did not show that the Debtor was not a responsible officer, and there were no similar opinion letters of counsel on the non-taxable nature of the subject transaction issued to the purchasing corporation or its officers, or that the Debtor ever relied on the legal opinion that was given to the lender on the transaction, the Department's evidence is sufficient to support allowance of the underlying claim on its merits. The Department concludes that the Trustee had the burden of proving that the Debtor's failure to pay the claimed tax was not willful, rather than on it to show that the Debtor's failure to pay was willful.

IV. *THE TRUSTEE'S ARGUMENTS*

The Trustee counters with numerous arguments in opposition to the Department's motion. First, the Trustee notes that the motion does not show that the Court made any manifest error of fact or law, nor is the Department proffering any newly discovered evidence. Second, the Trustee counters that the Department's motion raises a new argument under *Rago* – that a tardily-filed proof of claim cannot serve as a basis for disallowance of a claim – which was not urged at the time of trial, and is not properly advanced under Rule 59. Third, the Trustee points out that the Court in its Opinion had considered the *Hausladen* view and rejected same for reasons stated therein. Fourth, the Trustee asserts that notwithstanding *Hausladen*, the analysis contained in *Rago* is flawed, and has effectively been rejected in *In re Unroe*, 937 F.2d 346 (7th Cir.1991) and *In re Stavriotis*, 977 F.2d 1202 (7th Cir.1992). As additional authority the Trustee cites *Wilkens v. Simon Bros., Inc.*, 731 F.2d 462 (7th Cir.1984) (per curiam) in which the Seventh Circuit noted that both the text of the Bankruptcy Code and the Bankruptcy Rules must be considered in determining whether a claim is to be disallowed. *Wilkens* looked to the Rules then in effect under the prior Bankruptcy Act in holding that a Chapter 13 claim was required to be filed no later than six months after the initial creditors' meeting.

The Trustee thus urges the Court to adhere to its view that the text of section 502(b)(1) effectively provides for disallowance of late claims as "unenforceable" under "applicable law" which the Court found included the time limits of Bankruptcy Rule 3002(c). Next, the Trustee contends that the *Rago* analysis would not be applicable

here under the facts of this matter because the Department's subject claim was asserted to be an amendment to previously timely claims, rather than a new claim, merely tardily-filed, unlike the claimant in *Rago* which had no notice of the case or its claim prior to the expiration of the claims bar date. Hence, the Trustee maintains that the Department cannot now, on its motion for reconsideration, argue that the subject tardily-filed proof of claim constitutes an entirely new claim, rather than an amended claim previously argued.

The Trustee further asserts that properly applied principles of statutory construction compel relegation of the Department's tardily-filed claim to payment and classification under section 726(a)(3) and (a)(4). On this point, the Trustee argues that section 726(a)(3) is for unsecured claims which are tardily-filed, and are not of a type specified in section 726(a)(2)(C), such as the Department's claim at bar, except the portion thereof which is a claimed penalty which would be more properly classified under section 726(a)(4). Consequently, the Trustee concludes tardily-filed unsecured claims, whether entitled to priority treatment under section 507 or not, do not require treatment and payment under 726(a)(1). The text of the various subsections comprising section 726 which contains enumerations of specific exclusions from various subparagraphs, is indicative that section 726(a)(3) should apply to all cases involving late claim payments not specifically excluded.

An additional point argued by the Trustee is that by extending the result reached in *Rago* to this case, havoc is wreaked on dividend payments. Affording late priority claims with an equal treatment to timely-filed allowed

claims, notwithstanding established claims bar dates, forces objecting debtors, trustees and other interested parties to thereafter institute subordination actions against tardily-filed claims pursuant to 11 U.S.C. § 510. In this regard, the Trustee argues that if the Court follows the *Rago* result, then principles of equitable subordination should be applied here to equitably subordinate payment of any part of the Department's claim it favorably reconsidered because here, unlike the tax claimant in *Rago*, the Department knew of this case and filed several timely claims. Lastly, on the merits on the underlying claim, the Trustee contends that the motion merely challenges the Court's factual finding that there was no supporting evidence showing that the Debtor willfully failed to pay the claimed tax assessed. Such a challenge to the Court's factual findings cannot be appropriately made on a motion for reconsideration.

V. *DISCUSSION*

One crucial point to emphasize is that the process of bankruptcy claim allowance or disallowance pursuant to the provisions of section 502(b) and Bankruptcy Rules 3007 and 3008 is a separate and distinct aspect of estate administration from the related process of payment. Allowed claims are paid through distributions from the bankruptcy estate, as defined in section 541, made by the Trustee pursuant to section 704 and Bankruptcy Rule 3009, through the provisions of, and in the priorities established under, section 726. Frequently, these two separate, but related, steps of claim allowance and claim payment practically occur in close proximity. The real issue here, however, involves the disallowance of the

Department's claim under section 502(b)(1) and Bankruptcy Rule 3002(c), not any claim classification issues for distribution purposes under section 726 as the parties unnecessarily argue for the first time in this motion. Only claims allowed under sections 501, 502, 503 and 507, and not disallowed under section 502(b), receive distributions under the priorities established in section 726. Because the Department's claim was disallowed both as untimely and on the merits, section 726 classification issues are irrelevant and immaterial to the claim disallowance issues.

For purposes of this contested matter, one ultimate issue is whether the Court's prior ruling disallowing the Department's claim pursuant to Bankruptcy Rule 3002(c) violates section 502(b)(1) of the Code, and secondly whether the Court's ruling disallowing the Department's claim on the merits was in error. After carefully considering and reconsidering the arguments, and with all due respect to the learned decisions in *Hausladen* and *Rago*, the Court disagrees with those conclusions that Bankruptcy Rule 3002(c) conflicts with section 502(b)(1). Neither opinion discusses or focuses on the operative language in section 502(b)(1). As previously stated in the Court's Opinion, the plain meaning of section 502(b)(1) provides for disallowance of a contested claim, if same is unenforceable against the Debtor for *any* reason other than because it is contingent or unmatured. This reading of section 502 and the end result is supported by its sparse legislative history. *See* H.R.Rep. 595, 95th Cong. 1st Sess. 352 (1977); S.Rep. 989, 95th Cong.2d Sess. 62 (1977) U.S.Code Cong. & Admin.News pp. 5787, 5848, 6308. There is no limit either in the text of section 502(b)(1) or

its legislative gloss which precludes resort to the statute of limitation created by Rule 3002(c) as appropriate applicable law.

In the Rules Enabling Act, 28 U.S.C. § 2075, Congress empowered the Supreme Court of the United States to prescribe rules for the practice and procedure in cases under Title 11. Section 2075 expressly provides that such rules shall not abridge, enlarge or modify any substantive right. Accordingly, it has been held that the rule making power of the Supreme Court is limited and to be exercised consistently with the substantive provisions of Title 11. *In re Itel Corp.*, 17 B.R. 942 (Bankr.9th Cir.1982). Rules promulgated pursuant to section 2075 have the force of law pursuant to that authority granted by Congress. *In re Brooks Fashion Stores, Inc.*, 124 B.R. 436, 440 (Bankr.S.D.N.Y.1991). The bankruptcy court is bound to follow, without exceptions, the rules promulgated by the United States Supreme Court unless a rule is inconsistent with the statute, in which case the Bankruptcy Code controls over inconsistent procedural rules. *In re Wilferth*, 57 B.R. 693, 694 (Bankr.D.N.M.1986). Rules are entitled to a presumption that they were promulgated within the proper authority of the Supreme Court and do not affect substantive rights. *In re Neese*, 87 B.R. 609, 611 (9th Cir.BAP 1988). A party contending that a court rule violates substantive rights bears a heavy burden of proof. *Neese*, 87 B.R. at 611; *In re Management Data Services, Inc.*, 43 B.R. 962, 966 (Bankr.W.D.Wash.1984). The Court concludes that the operative text of section 502(b)(1) can be harmoniously construed and applied through the statute of limitations provided by Bankruptcy Rule 3002(c).

The Court rejects the Department's argument that Bankruptcy Rule 3002(c) patently conflicts with the distribution scheme of section 726. In bankruptcy estates where there is sufficient money or other liquidated assets to pay allowed priority claims that have been filed under section 726(a)(1), then after all claims at that distribution level under section 726 have been paid in full, to the extent there are additional estate funds on hand to pay claims that fall under section 726(a)(2), those proceeds are distributed pro rata to claim holders falling in that class. If there are sufficient funds on hand to fully pay all claimants in that class of claims, the excess is then distributed down to the section 726(a)(3) level of tardily-filed claims. Although infrequent, occasionally there are bankruptcy estates in which there are sufficient funds to pay all claims timely and tardily-filed leaving an excess to cover payment of penalty, fines or punitive damage claims under section 726(a)(4). If those claims are all paid in full, then distribution of post-petition interest is paid to allowed claim holders under section 726(a)(1)-(4) pursuant to section 726(a)(5). Thereafter, any surplus of the estate is to be paid to the debtor pursuant to section 726(a)(6). In such cases, there is no need for a trustee to object to late claims because there is enough to pay all claims.

In the vast majority of Chapter 7 estates, however, like the case at bar, there are insufficient assets to pay all allowed claims that are timely filed whether priority under section 726(a)(1), or unsecured under section 726(a)(2)(A). It is precisely in cases such as this, where there are not enough assets to pay all claim holders, that

the impact of Bankruptcy Rule 3002(c) becomes important. It is not logical to extend the first priority in distribution under section 726(a)(1) to tardily-filed claims because section 726(a)(2)(A) and (B) provides that timely-filed allowed claims take priority over tardily-filed allowed claims under section 726(a)(2)(C) and (a)(3). Moreover, the Department's classification argument only impacts on allowed claims. This matter, however, focuses on its claim disallowed under 502(b)(1), rather than the distribution classification scheme under section 726. Therefore, it is unnecessary, for proper determination of this matter, to categorize the Department's claim under section 726, had it not been disallowed, nor address the equitable subordination arguments newly raised by the Trustee. The Court need not reach such subordination and classification issues discussed in *Rago*. Only allowed claims are entitled to receive distributions from the estate. Thus, the principal focus and discussion in *Rago* concerning section 726 is inapposite and not controlling in this matter.

The result reached here is also in accord with *United States v. Vecchio*, 147 B.R. 303 (E.D.N.Y.1992). There the bankruptcy court disallowed two claims of the Internal Revenue Service which were filed late. Similar to the tax claimant in *Rago*, the IRS in *Vecchio* argued that it should be entitled to section 726(a)(1) treatment. The district court on appeal held that the IRS's late claims should be relegated to section 726(a)(3) status, and same extends to all tardy claims, both priority and non-priority. *Id.* at 306. *Vecchio* cited with approval *In re Global Precious Metals, Inc.*, 143 B.R. 204 (Bankr.N.D.Ill.1992), which found that a creditor without notice is protected by section 726(a)(2),

but otherwise the ninety-day filing requirement of Bankruptcy Rule 3002(c) applies. *Vecchio* noted that judicial efficiency, certainty and finality with respect to bankruptcy proceedings would be severely hampered if creditors with priority claims were able to assert them at any time, regardless of having received timely notice of the bankruptcy proceeding. 147 B.R. at 307. The contrary view espoused in *United States v. Cardinal Mine Supply, Inc.*, 916 F.2d 1087 (6th Cir.1990), urged by the Department, is rejected. The *Vecchio* court concluded that a broad reading of *Cardinal Mine* does not subsume the Bankruptcy Rule 3002(c)(1) ninety-day deadline with regard to federal tax claims, it makes the Rule inapplicable, wherever a priority claim is allegedly asserted. 147 B.R. at 307. A creditor could appear years after receiving timely notice of the bankruptcy, and if his claim was a priority claim, it would be protected. That result is inequitable especially under the facts of this matter. The controlling law and equities of the case militate in favor of the Trustee's position, and against that taken by the Department.

On the merits of the underlying claim and the objection thereto, there was no evidence furnished at trial that the Debtor's failure to pay the subject claim was willful. Contrary to the Department's arguments, the Department had the burden of proof to show the Debtor's failure to pay the subject claim was willful, rather than the Trustee, as the objector, having the burden to show that the Debtor's failure to pay was not willful. No evidence was adduced by the Department to show that the Debtor's failure to pay the claimed tax was a voluntary, conscious and intentional failure as required by the controlling

holding in *Department of Revenue v. Heartland Invest., Inc.*, 106 Ill.2d 19, 30, 86 Ill.Dec. 912, 476 N.E.2d 413 (1985). The other case cited by the Department, *Quincy Trading Post*, did not involve assessment of a tax liability against a responsible corporate officer under 35 ILCS 120/13 1/2, and is therefore inapposite and not on point.

A recent opinion of the Seventh Circuit dealing with contested bankruptcy claims provides instructive dicta: "[e]nforcing the Bankruptcy Rules according to their terms cannot be an abuse of discretion." *In re Danielson*, 981 F.2d 296, 299 (7th Cir.1992). Although *Danielson* did not decide the issues raised here, it expressly references Bankruptcy Rule 3002(c), noting that the Seventh Circuit regularly holds that sloth, ignorance or other negligence does not qualify as excusable negligence warranting enlargement of time under Bankruptcy Rule 9006(b)(1). *Id.* at 298. *Danielson* cites *Unroe* with approval and *Taylor v. Freeland & Kronz*, ___ U.S. ___, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992), which noted that courts have no standby power to excuse violations of statutes and rules. In addition, in *Holstein v. Brill*, 987 F.2d 1268 (7th Cir.1993), the court, in discussing amendments to claims, noted: "[l]eave to amend should be freely granted . . . but passing milestones in the litigation make amendment less appropriate. One milestone of particular significance in bankruptcy is the bar date." *Id.* 987 F.2d at 1270.

VI. *CONCLUSION*

For the foregoing reasons, the Court hereby denies the Department's motion for reconsideration.

This Opinion serves as findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.